ECONOMIC DEVELOPMENTS IN PORTUGUESE-SPEAKING AFRICAN COUNTRIES AND TIMOR-LESTE

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2020-2021

Statistical data and underlying chart data
are available in the attached files.

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Contents

Editorial

The Banco de Portugal has been publishing *Economic developments in Portuguese-speaking African countries and Timor-Leste* since 1994 to contribute to a better understanding of the economic reality of these countries. The information provided, compiled on a comparable and consistent basis, is complemented by developments at global level and developments in bilateral economic and financial relations with Portugal.

This year's edition presents the usual assessment of the economic environment, focusing on the impact of the COVID-19 pandemic in 2020, and, based on available information, developments in and the outlook for 2021, in an environment of still high uncertainty.

Three highlights were added: the first on the IMF's support to low-income countries in the response to and recovery from the pandemic crisis; the second on the impact of climate change on policy agendas; and the third on changes to the methodology for calculating effective exchange rate indices introduced in this edition.

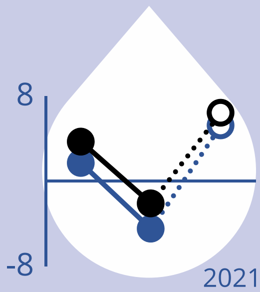
Several institutions were instrumental to the completion of this publication.[1] We would particularly like to express our gratitude to our counterparts, the central banks of Angola, Cabo Verde, Mozambique, São Tomé and Príncipe and Timor-Leste, as well as the national branch of the Central Bank of West African States in Guinea-Bissau.

October 2021

1. The statistical data supporting this edition were mostly collected before the end of August 2021.

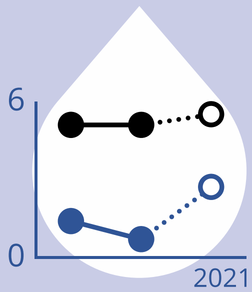
I International environment

World economy
Recovery prospects



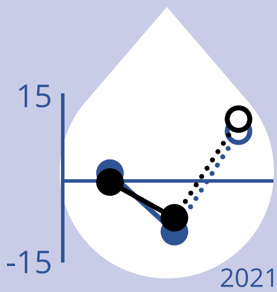
ECONOMIC GROWTH
%

Emerging and developing economies
Advanced economies



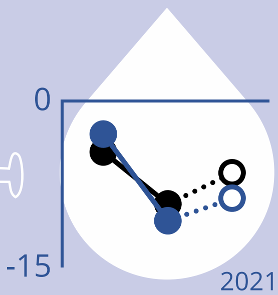
INFLATION
year-on-year % change

Emerging and developing economies
Advanced economies



INTERNATIONAL TRADE
goods and services
imports and exports
real % change

Emerging and developing economies
Advanced economies



FISCAL BALANCE
% of GDP

Emerging and developing economies
Advanced economies

1 Recent developments and outlook

The COVID-19 pandemic caused a severe contraction in global activity, with GDP falling by 3.1% in 2020. The crisis was an adverse exogenous shock that affected all economies and had mixed consequences. Global pandemic developments and the impact of containment measures chiefly affected contact-intensive economic sectors. However, the effects of the crisis were mitigated by swift action and widely implemented incentives and policies aimed at protecting the population and at preserving their livelihood.

Global economic recovery should progress at different speeds. IMF projections point to 5.9% growth in 2021 (a muted revision from the previous projection of 6% in July 2021), although some effects of the pandemic may persist in the medium term, affecting the accumulation of human capital and the reduction of inequalities. In advanced economies, economic projections for 2021 were influenced by the US economy's performance, reflecting a strong fiscal stimulus in 2020 and 2021. The economic recovery in emerging and developing Asia explains the developments projected for the aggregate of emerging economies, particularly China (the first economy to suffer the impact of the pandemic and the first to begin the process of economic recovery, as early as the second quarter of 2020). The most recent projections for these economies remain conditioned by the resurgent COVID-19 outbreaks in emerging Asia and in Africa. Lastly, it is worth mentioning the incomplete recovery in Latin America and the Caribbean in 2021 and the performance projected for sub-Saharan Africa, which puts at risk this region's goals of economic and social convergence (3.7% growth in 2021).

The fall in economic activity and global demand caused by the pandemic crisis resulted in an 8.2% contraction in international trade in 2020, despite the pick-up observed in the second half of the year, as economies reopened. International trade is expected to grow by 9.7% in 2021 due to the increased momentum in the industrial sector, outperforming the recovery projected for global activity. In turn, the rebound in international trade in services is still highly conditioned by pandemic developments and the persistence of travel restrictions affecting consumer confidence and, thus, hindering the upturn in the tourism sector.

In overall terms, inflation remained stable throughout 2020 and even decreased slightly in advanced economies, reflecting the combined effect of a contraction in demand and a marked fall in oil prices in the first half of the year. Prospects of an increase in global demand and a recovery in activity led to a pick-up in commodity prices, particularly oil prices. In emerging and developing countries, inflation rate developments projected for 2021 are likely to be linked not only to pandemic-related transitory pressures but also to the rise in food prices.

Financing conditions should remain favourable overall, albeit with different paths across advanced economies and emerging and developing economies. In advanced economies, monetary policy is expected to remain accommodative, as long as inflation remains contained and expectations anchored. Conversely, pressures on domestic prices in some emerging and developing economies have led to the reversal of more accommodative monetary policy measures, while the intensification of specific risks, coupled with pandemic risks, may contribute to a widening of credit spreads, higher financing costs and currency depreciation. Moreover, expectations of an early normalisation of US monetary policy measures may have a negative effect on capital flows to emerging and developing economies.

In terms of the economies of the Portuguese-speaking countries under review – Angola, Cabo Verde, Guinea-Bissau, Mozambique, São Tomé and Príncipe and Timor-Leste – it is likely that pandemic control measures helped maintain the associated mortality rate at low levels, despite the adverse effects on domestic activity and demand.

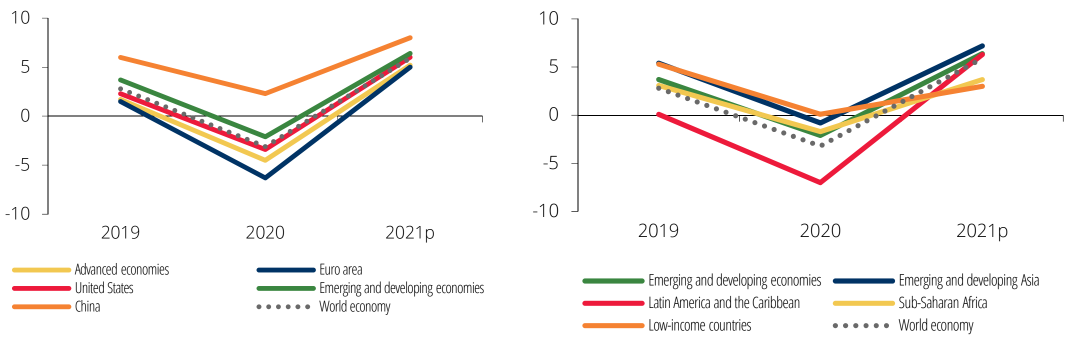
One notable common feature is the increase in financing needs, largely covered by external aid from cooperation partners and bilateral creditors, due to an abrupt fall in tax revenue and greater expenditure on health and measures to support households and firms, resulting in higher indebtedness levels. The pandemic crisis also affected exports (particularly Cabo Verde, Mozambique and São Tomé and Príncipe) and, to a lesser extent, foreign direct investment and emigrants' remittances. In 2021, the widespread increase in food and oil prices has contributed to a rise in inflation.

Economic activity is still vulnerable to developments in the pandemic, reinforcing the importance of the vaccination process on a global scale. This process should make way for the loosening of control measures. Current economic growth **prospects** point to a worldwide increase in inequality and higher dependence of the most fragile economies on external financing, especially on concessional financing and development aid. In these economies, the ongoing crisis has eroded the already narrow policy space and is threatening to jeopardise debt sustainability levels, while the resumption of economic growth paths implies the continuity of structural reforms, which is essential to overcoming existing impediments, notably by improving education, productivity, employment and investment levels.

Global **challenges** have emerged with a new impetus in the post-pandemic period, with national and international institutions dedicated to accelerating the digital transition and in promoting a 'green recovery', thereby amplifying the future financing needs of economies, in particular, of emerging and developing economies.

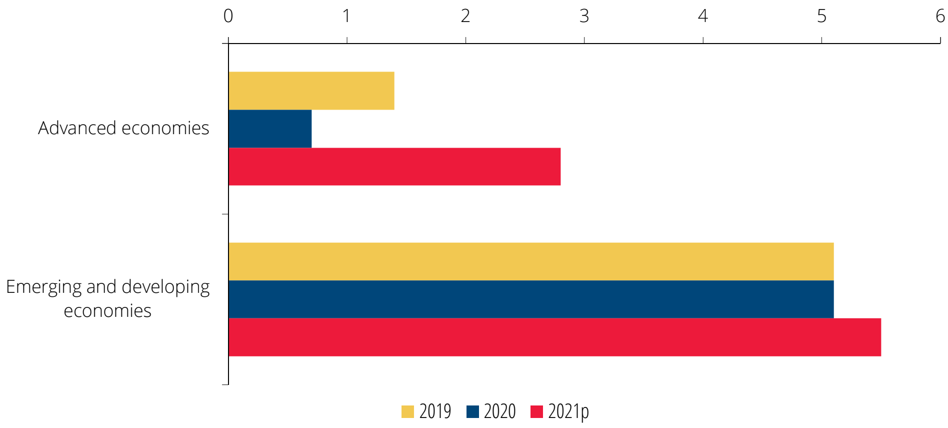
Beyond its response to the health emergency and the crisis, international cooperation will continue to play an important role in the reconciliation of a post-pandemic, sustainable and inclusive economic recovery and the promotion of global solutions. Global **risk** management requires a collaborative approach and the wide involvement of society, particularly that of governments and central banks. It also requires the adaptation of instruments and strategies of international institutions and cooperation partners.

Chart I.1.1 • Real GDP | Annual % change



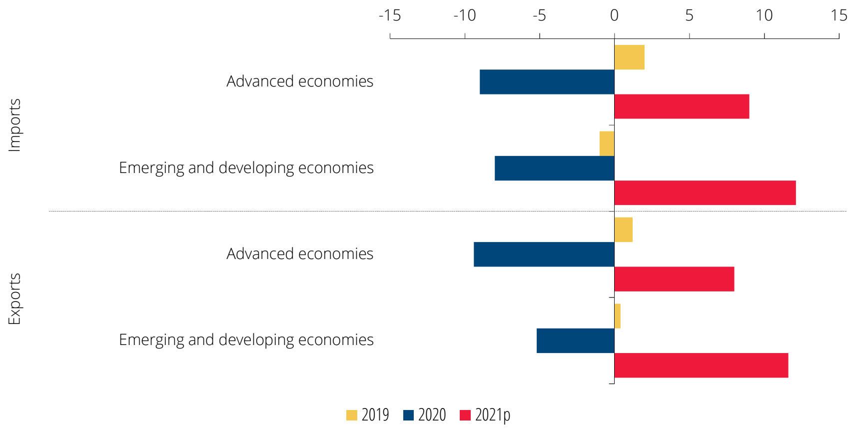
Source: IMF, *World Economic Outlook* (cut-off date: 12 October 2021).

Chart I.1.2 • Inflation | Year-on-year % change in the CPI



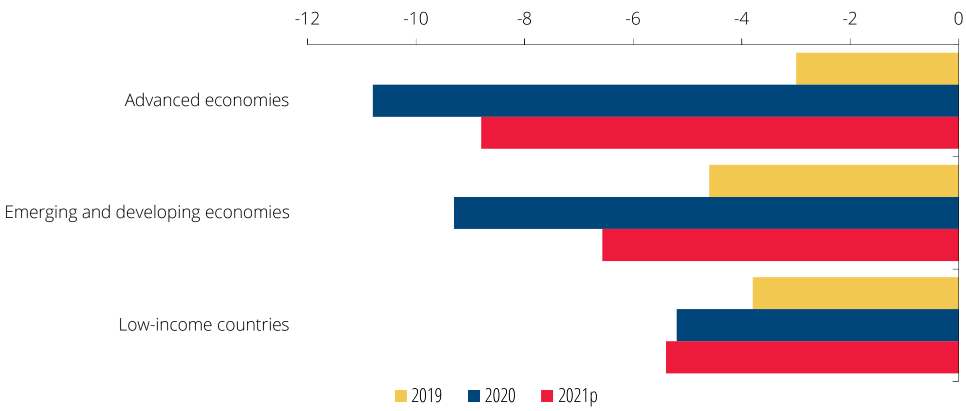
Source: IMF, *World Economic Outlook* (cut-off date: 12 October 2021).

Chart I.1.3 • International trade (exports and imports of goods and services) | Real % change



Source: IMF, *World Economic Outlook* (cut-off date: 12 October 2021).

Chart I.1.4 • Fiscal balances | % of GDP



Source: IMF, *World Economic Outlook* (cut-off date: 12 October 2021).

Box 1 • IMF support to low-income countries while addressing the pandemic crisis and fostering the recovery

Low-income countries have been severely affected by the global crisis triggered by the COVID-19 pandemic. The asymmetric impact of the crisis has posed particular challenges to these economies, threatening past growth and development gains and increasing the risks of uneven recovery.

The IMF, as a central element of the global financial safety net, gave a quick and sizeable response, aiming to address the needs of its members, particularly the most vulnerable. Initially, financial assistance was mainly provided through the emergency facilities or the augmentation of ongoing programmes.

As the health crisis is not over and it is necessary to manage the impact of the crisis and promote a sustainable and inclusive recovery, the financing needs of low-income countries are expected to remain high in the coming years. The IMF is therefore shifting its response towards concessional financing through multi-year lending arrangements to support national development strategies and promote economic policies aimed at sustainable growth. In this context, the IMF approved important reforms to the Poverty Reduction and Growth Trust (PRGT) in July 2021. These include increased access limits, maintaining zero interest rates until July 2023 and reinforced safeguards on debt sustainability and credit risk. Alongside these reforms, a strategy has also been adopted to increase the financial resources of the PRGT and ensure its self-sustainability.

One of the most recent and relevant IMF measures in response to the pandemic crisis was approved and implemented in the summer of 2021. Following a broad international consensus, a general allocation of Special Drawing Rights (SDR) was approved for an amount equivalent to USD 650 billion – the largest ever allocation. It is a quick and supplementary response to the efforts to tackle the crisis and mitigate scarring, with a view to strengthening trust and cooperation at a global level and support countries with liquidity needs, making the necessary adjustment smoother.

This allocation is considered particularly relevant for emerging and developing economies, more so for low-income countries. Its impact will benefit from the ease of use and channelling of SDRs post allocation, especially from members with stronger external positions to members in greater need. Options for voluntary SDR channelling will therefore be key, using existing instruments (such as the PRGT) or new mechanisms aimed at helping vulnerable countries address the pandemic and structurally transform their economies.

In addition, support for the most vulnerable members has also been consolidated through: new rounds of temporary relief of debt service to the IMF under the Catastrophe Containment and Relief Trust (CCRT); the extension – until the end of 2021 – of the Debt Service Suspension Initiative (DSSI) for bilateral official creditors, endorsed by the G20 and Paris Club; and the G20 and Paris Club agreement, in November 2020, on the Common Framework for Debt Treatments beyond the DSSI.

International cooperation was one of the central elements in the response to the pandemic crisis and IMF action is framed under a collaborative approach with other international institutions and partners.

The table below summarises the use of these facilities and initiatives by the Portuguese-speaking African countries, in line with their specific circumstances, national strategies and particular needs. It also lists the amount allocated to each country under the general SDR allocation.

Table C1.1 • Portuguese-speaking African countries – access to facilities and initiatives and general SDR allocation | Millions*

	Extended Credit Facility (ECF)**		Extended Fund Facility (EFF)**		Rapid Credit Facility (RCF)		Catastrophe Containment and Relief Trust (CCRT)		Debt Service Suspension Initiative (DSSI)***	General SDR allocation
	USD	SDR	USD	SDR	USD	SDR	USD	SDR	USD	SDR
Angola	–		765.7	540.4	–		–		4,171	709.4
Cabo Verde	–		–		32.3	23.7	–		49.7	22.7
Guinea-Bissau	–		–		20.5	14.2	4.99	3.56	5.6	27.2
Mozambique	–		–		308.9	227.2	41.66	29.82	758.7	217.8
São Tomé and Príncipe	2.08	1.48	–		12.29	9.03	0.63	0.46	5.8	14.2

* Amounts in the currencies disclosed. For reference, the SDR/USD exchange rate on 31 August was 1.42426. **Value of increased access to the facility. *** Amounts estimated on 31 August 2021, relative to the potential value of a moratorium on the bilateral official debt service between May 2020 and December 2021 (World Bank).

Box 2 • Climate change: general reasoning and central banking

Over the past few years, climate change has emerged as one of the main global issues of our time, particularly since the Paris Agreement (December 2015). It is widely recognised today as a real global risk requiring global cooperation and solutions. It is also one of the few issues kept at the top of international agendas even since the beginning of the pandemic crisis, as shown by recent initiatives, such as the EU's Fit for 55 package (July 2021) or the Biden Plan as presented at the Leaders' Climate Summit (April 2021).

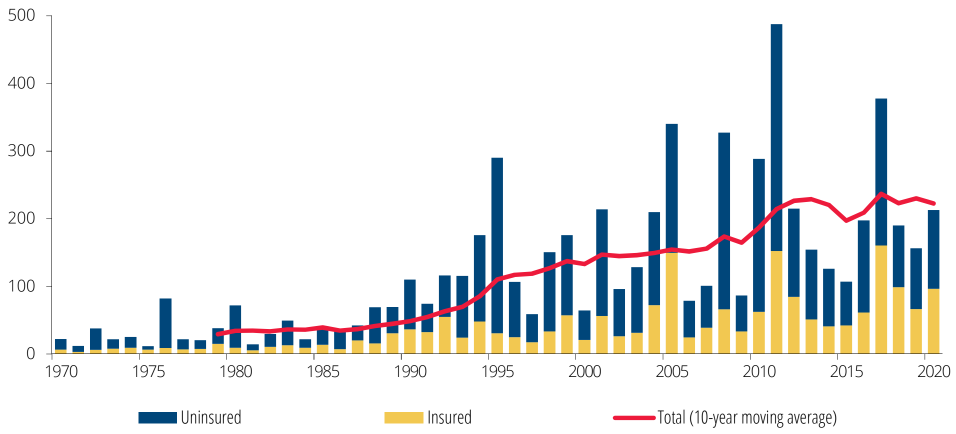
In a context where the notion of green recovery – the conciliation between post-pandemic short-term economic recovery and long-term solutions to climate change – is gaining ground, commitments to achieve a so-called net zero goal are multiplying. Undertaken by government authorities, other official entities and private institutions, these commitments generally translate into the establishment of a time horizon to reach the goal of net zero greenhouse gas (GHG) emissions, meaning the difference between gross emissions and GHG capture – e.g. 2050 in the EU and the United States or 2060 in China.

This energy transition entails a deep transformation that will certainly take different forms depending on the context. The UN's Intergovernmental Panel on Climate Change (IPCC) foresees somewhat more serious impacts for the majority of developing countries, as the rate and severity of natural disasters increases. Countries more dependent on fossil fuel production (such as Angola, Timor-Leste and soon Mozambique) will also be particularly affected. A report published by the International Energy Agency on 18 May illustrates this perspective well. It recommends an immediate end to investments in new oil and natural gas projects so as to reach net zero emissions by 2050 and it also estimates that by that time, demand for oil and natural gas will have decreased by 75% and 71%, respectively, when compared with 2019 levels.

It is usually acknowledged that the economic policy instruments most effective in counteracting negative externalities, such as climate change, belong to governmental authorities. However, the cross-cutting and far-reaching nature of the phenomenon has led to greater involvement of society at large. Central banks are also increasingly involved, both individually and through an organisation created in December 2017 to exchange experiences and best practices: the Network for Greening the Financial System (NGFS). By the end of August 2021, this network already had 95 members (including the Banco de Portugal, since December 2018).

This fast expansion in terms of participants, technical work and public repercussion is also a recognition of the direct relevance of climate change to the mission and activities of central banks. Indeed, it is a source of risk to financial stability, it affects the monetary policy framework and is an important factor for the business models of supervised institutions. Climate change is also relevant to the development of economic research, production of statistics, asset management, own risk management and the mitigation of our ecological footprint. All in all, climate change is important for the effective performance of central bank tasks.

Chart C2.1 • Losses from natural disasters | 1970–2020, USD billions



Source: Swiss Re Institute.

2 Portuguese-speaking countries

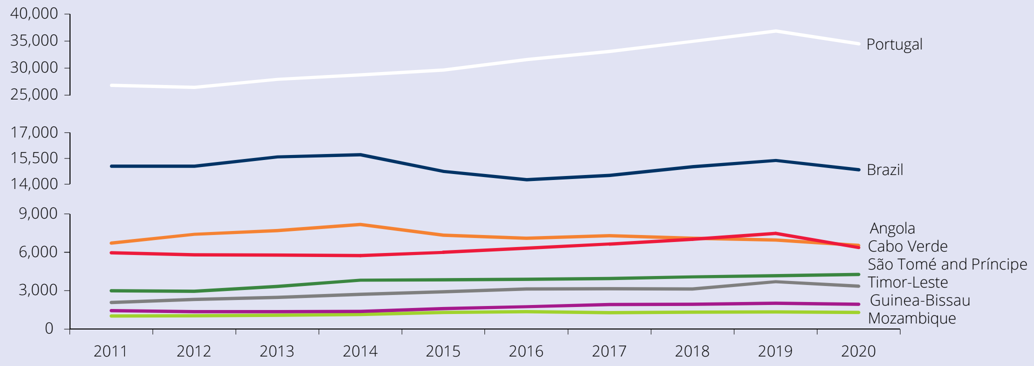
Socio-economic Indicators

Table I.2.1 • Portuguese-speaking countries worldwide – a comparison of various dimensions

	ASEAN	Mercosur	SADC	UE	PSC	Germany	China	United States	India	Japan	Russia
Land area Thousand km²	4,496	12,774	9,883	5,255	10,709	357	9,597	9,629	3,288	378	17,075
Population Million inhabitants, 2020	667	297	362	445	291	84	1,447	331	1,380	126	146
Gross domestic product EUR billions, current prices, 2020	2,698	1,717	524	13,279	1,522	3,330	12,890	18,327	2,372	4,420	1,290
Goods exports EUR billions, 2020	1,212	250	128	4,778	205	1,208	2,269	1,253	242	562	290
Foreign exchange reserves EUR billions, 2020	938	366	79	1,308	349	219	2,836	549	481	1,177	400
Internet users % of total population, 2020	66	76	29	90	60	96	63	90	41	94	80
	ASEAN	Mercosur	SADC	UE	PSC	Germany	China	United States	India	Japan	Russia

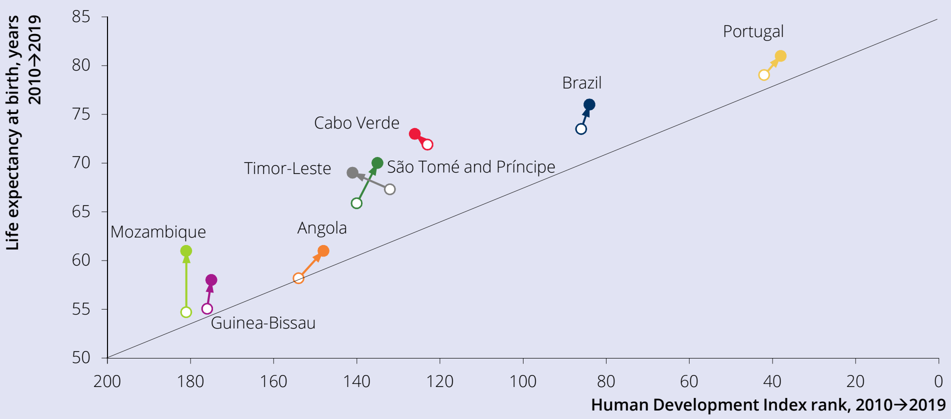
Sources: World Bank, United Nations, International Monetary Fund, CIA – World Factbook, Internet World Statistics and World Trade Organization | Note: Including intra-EU exports. | Key: PSC – Portuguese-speaking countries, EU – European Union, ASEAN – Association of Southeast Asian Nations, SADC – Southern African Development Community, Mercosur – Common Market of the South.

Chart I.2.1 • GDP per capita | USD, PPP, current prices



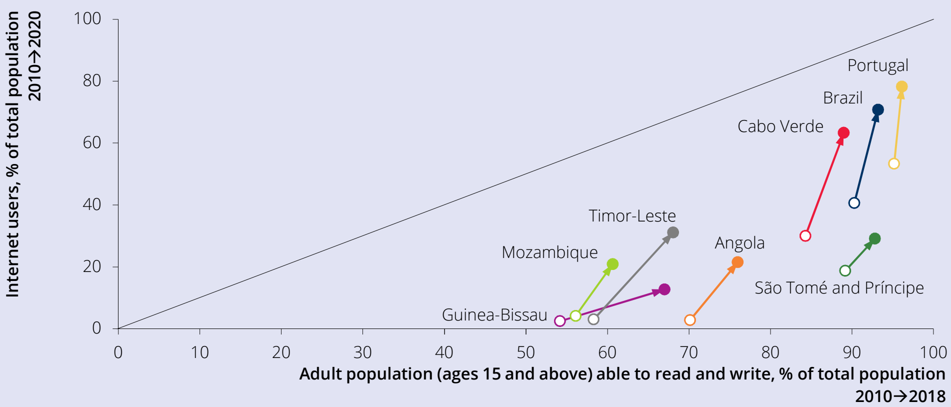
Source: World Bank. | Note: PPP – Purchasing power parity. Alternative currency conversion, without using market rates. It is based on the comparison of prices in the local currency for the same basket of goods in different countries.

Chart I.2.2 • Life expectancy vs. Human Development Index



Source: World Bank and UNDP. | Note: Human Development Index: United Nations Development Programme's (UNDP) composite index of life expectancy, education, and income indicators (188 countries in 2010; 189 countries in 2019).

Chart I.2.3 • Internet users vs. Literacy



Source: World Bank and CIA – World Factbook.

II Economic developments in Portuguese-speaking African countries and Timor-Leste

1 Angola

2 Cabo Verde

3 Guinea-Bissau

4 Mozambique

5 SãoTomé and Príncipe

6 Timor-Leste

1 Angola

Area 1,246,700 km²

Capital city Luanda

Population 32.9 million (2020; source: United Nations)

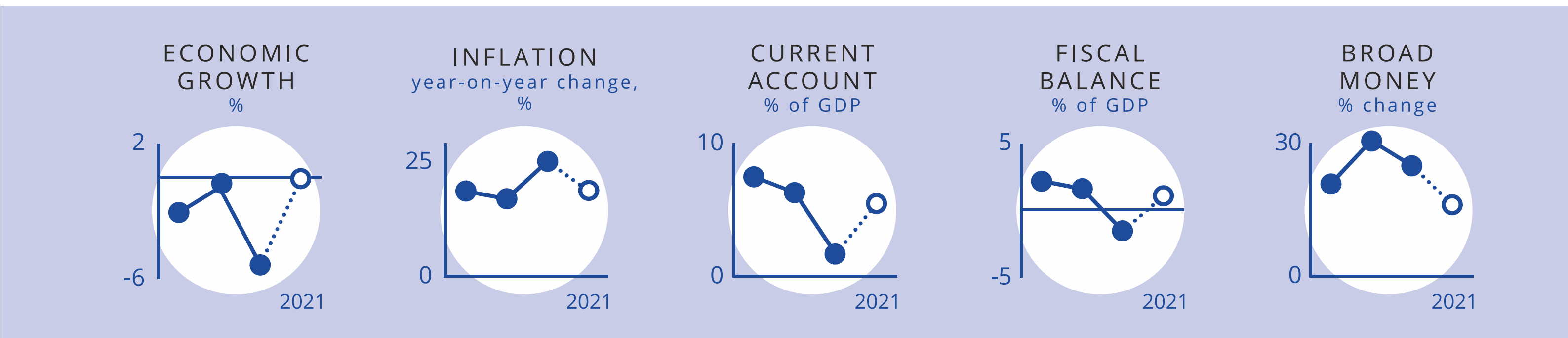
Currency Kwanza (AOA)

The 2014-15 oil shock marked the beginning of a protracted recession for the Angolan economy, whose growth model is dependent on the oil sector. The authorities have followed an agenda of reform since 2018, focused on macroeconomic stabilisation, diversification of the productive sector, private sector led growth and strengthening of public institutions. To implement these policies, Angola requested an extended arrangement from the IMF and gained access, in 2018, to a USD 3.7 billion loan under the Extended Fund Facility (EFF) ending in 2021.

In 2020, the health crisis caused multiple shocks to the economy, exacerbating existing challenges. The oil sector was heavily affected by the combined effects of falling prices and contraction in demand, with spillover effects on the non-oil sector, also constrained by sanitary restrictions. GDP fell by 5.2% in 2020, the biggest drop since the end of the civil war in 2002, increasing poverty and inequality rates. Despite the measures implemented in response to the health crisis, the authorities remained strongly committed to the consolidation and adjustment policies, which, together with the debt renegotiation agreements, has allowed for positive assessments of the ongoing arrangement. Monetary policy sought to accommodate the impacts of the crisis in the first half of 2020, ensuring access to liquidity and fostering lending. The easing of the exchange rate regime introduced in October 2019 boosted the sharp depreciation of the kwanza, an acceleration of inflation and an increase in debt. The external accounts suffered from the contraction in oil exports, despite the flexible exchange rate regime.

As the pandemic crisis evolves, the 2021 policy agenda includes monetary stabilisation by tightening the monetary policy, increasing fiscal and debt sustainability, accelerating structural reforms and safeguarding financial stability, with a focus on the restructuring of two state-owned banks, as well as alleviating poverty rates made worse by the pandemic.

The fragility of the oil sector will continue to constrain the growth of the Angolan economy. Domestic demand is expected to recover gradually, depending on pandemic developments and on the recovery of household income. The IMF estimates a contraction of 0.1% in 2021, with expected delays in oil sector investments being the main factor for the downward revision of output growth.



In its fifth consecutive year of recession, Angolan **GDP** contracted by 5.2% in 2020. The pandemic caused multiple shocks to the economy, especially the collapse of oil demand and prices in the 1st half of 2020. The oil sector contracted by 8%, worsening the decline in oil production in a context of low investment and operational difficulties. The non-oil sector fell by 4%, despite the resilience of the agricultural sector and the partial recovery of other sectors from the 3rd quarter onwards due to the easing of sanitary restrictions. The impact of the pandemic is still visible on the economic and social fronts, despite subsiding macroeconomic pressures. The IMF forecasts a 0.1% contraction in output for 2021, with the oil sector falling by 7%. The slowdown in investment and the difficulties caused by the pandemic have restricted oil production despite rising prices globally. The recovery of the non-oil sector will be gradual, considering the limited capacity for countercyclical intervention, and is expected to expand by 2.3% in 2021. Developments in the pandemic had a positive impact on domestic demand until the first quarter of 2021, but the upsurge in infections in April necessitated further containment measures. Adverse weather events at the beginning of 2021 disrupted agricultural production and transport, imposing additional constraints on economic recovery.

The adoption of the flexible exchange rate regime and the entry into force of VAT at the end of 2019 marked the beginning of a period of acceleration in **inflation**, which stabilised after the 4th quarter of 2020. Despite fiscal consolidation and a negative output gap, disruptions to production chains and an accommodative monetary policy worsened the price growth trend, with the year-on-year inflation rate surging from 16.9% in 2019 to 25.1% in 2020. The stabilisation of the kwanza as of May 2021 and the gradual tightening of monetary policy contributed to the flattening of the inflation curve, with the year-on-year rate standing at 24.9%. The authorities point to an annual inflation rate of 18.7% at the end of 2021, benefiting from a tighter monetary policy stance.

The pandemic contributed to the deterioration of the **external accounts** in 2020, with exchange rate flexibility helping in the adjustment to exogenous shocks. The collapse in oil prices and demand led to a 40% drop in exports in 2020. The sharp contraction in imports, the lower level of income transfers from oil companies abroad and the higher-than-expected recovery in oil prices contributed to a current account surplus of 1.6% of GDP. The bilateral agreements renegotiating external debt and the agreements signed under the Debt Service Suspension Initiative (DSSI) took some pressure off external accounts. Even so, and despite the stabilisation of foreign direct investment, there was an overall external deficit of 7.7% of GDP in 2020, offset by the reduction in net international reserves as well as by exceptional external financing. The external position is expected to improve in 2021, with a current account surplus of 5.3% of GDP, as a result of the positive developments in oil prices and lower import levels than before the pandemic. While foreign direct investment is projected to decline, a slight build-up of international reserves is expected.

The Government has made a consistent effort to consolidate **public finances**, by containing primary expenditure and committing non-oil revenue. The pandemic crisis contributed to a fiscal deficit of 1.6% of GDP, while the primary balance recorded a surplus of 5.8% of GDP in 2020. The 2.6 p.p. drop in oil revenue as a percentage of GDP required the adoption of a supplementary budget, revising the reference oil price per barrel downwards to USD 33. Non-oil revenue grew by 1.8 p.p. as a percentage of GDP, driven mainly by VAT and tax efficiency measures. This increase led to the reduction of the non-oil primary balance to -5.5% of GDP in 2020, exceeding the IMF arrangement target. The fiscal deficit and the depreciation of the kwanza induced the debt ratio increase to 135% of GDP by the end of 2020. Without access to the international capital market, the use of government deposits and the disposal of assets (including the mobilisation of USD 1.5 billion from the Sovereign Fund in 2020) were not sufficient to cover the Government's financing needs. The Government benefited from access to multilateral external financing, including the EFF provided by the IMF and budgetary support from the World Bank and the African Development Bank, plus bilateral debt renegotiation agreements and agreements under the DSSI. The 2021 budget forecasts an overall surplus of 1%, a primary surplus of 7.2% and a reduction of the public debt ratio to 113% of GDP. Oil revenue will recover, benefiting from higher international prices. However, the budget is based on a conservative scenario for oil prices (USD 39) and the authorities have signalled the allocation of the likely surplus in oil revenue towards extraordinary expenditure to fight the epidemic outbreak and reduce debt. Containing primary expenditure will reduce the non-oil primary balance to 4.4% of GDP.

With the easing of the exchange rate regime, the kwanza depreciated by 51% against the dollar in 2020. From the 4th quarter onwards, the increase in foreign exchange supply caused by higher oil prices allowed the kwanza to stabilise, a trend that has continued in 2021. The BNA remains committed to the reform of the foreign exchange regime, limiting its intervention to mitigating excess volatility. In 2020, the introduction of a trading platform in the interbank money market was a step forward and contributed to decrease the spread between official and parallel exchange rates, which was below two digits in April 2021.

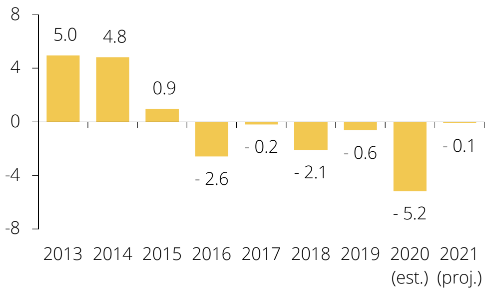
An accommodative monetary policy was implemented in response to the impacts of the crisis in the first half of 2020, notably: introducing a liquidity facility in national currency to purchase privately held public debt securities; keeping the key interest rate below the inflation rate; establishing a programme to encourage lending to key sectors; and the introduction of a custody fee on excess reserves. As the effects of the pandemic shock softened, the BNA reversed the policy stance to contain monetary expansion and rising inflation. 2021 saw an increase in the marginal lending and liquidity-absorbing facility rates, the use of open market operations for absorbing liquidity and the increase in reserve requirement ratios.

In a context of protracted recession, high inflation and currency depreciation, the deterioration in the quality of credit portfolios pressures the banking system, as its solvency is vulnerable to further depreciation of the kwanza. An asset quality review in 2019 identified recapitalisation needs to the amount of USD 2.4 billion, 96% of which for two state-owned banks, leading to restructuring processes. The authorities have promoted the write-down of losses in line with expected credit losses, as well as the active management of non-performing loans (NPLs). The default ratio has followed a downward path, standing at 18.7% in May 2021 and there is currently no moratorium. The capital ratio suffered from the sector's net losses in 2020, particularly in the case of public banks, and stood at 18.6% in May 2021.

The authorities remain committed to the programme of structural reforms and stronger governance, despite the pandemic having caused some delays. The Public Finance Sustainability Law, adopted in 2020, includes a rule for debt sustainability and a medium-term fiscal framework, enhancing the transparency and predictability of fiscal policy. The privatisation programme, under which 39 firms were privatised (out of 126 as initially planned) in 2020, foresees the sale of 100 companies in 2021. The Government continues to invest in key infrastructure projects, with a focus on electricity and water, with support from the World Bank and the African Development Bank. In 2021, two new laws were enacted, the Financial Institutions Law, establishing a prudential and resolution framework, and the BNA law, which strengthens the central bank's power to intervene. Also noteworthy in terms of the financial system was the enactment of the Law on Combating Money Laundering and the Financing of Terrorism and Proliferation and the development of the strategy to reduce the burden of the state on the banking system.

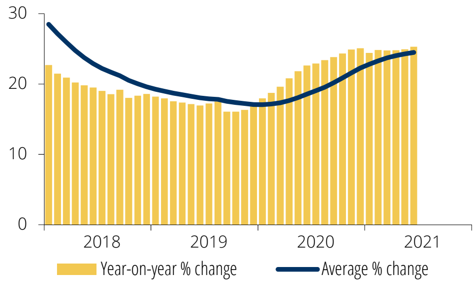
The lasting effects of the health crisis, the developments in the oil market and the sustainability of public debt are the main risks for the Angolan economy. The fragility of the oil sector is expected to continue to constrain economic growth. In turn, the recovery of the non-oil sector and of domestic demand depends on the containment of the pandemic and success of the vaccination campaign. The successful implementation of the social transfers programme, supported by the World Bank, is a key element in mitigating the effects of the crisis and preserving social stability. Medium-term growth prospects remain constrained by the success of ongoing structural reforms, dependent on international dynamics and external support.

Chart II.1.1 • Real GDP | Annual % change



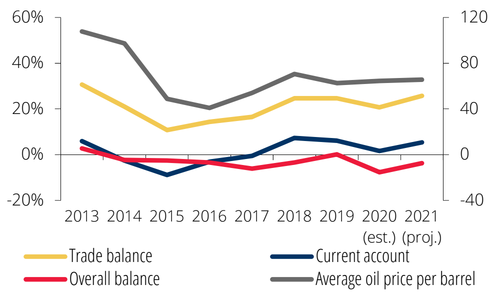
The oil shock of 2014-15 led to a protracted recession, significantly worsened in 2020 by the effects of the pandemic.

Chart II.1.2 • Inflation | Annual % change in the CPI



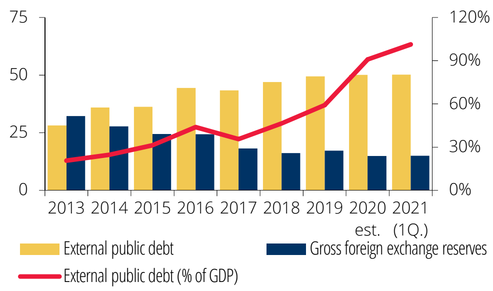
The pandemic shock accelerated currency depreciation, leading to higher inflation. A stable exchange rate and a tight monetary policy stabilised price growth from the end of 2020.

Chart II.1.3 • Balance of payments and oil prices | % of GDP, average oil price per barrel in USD



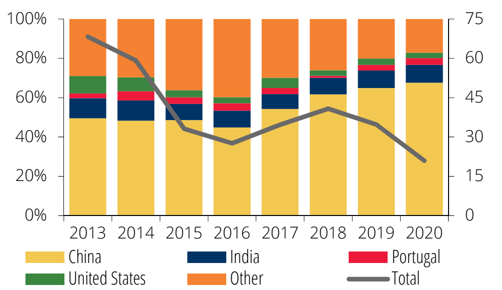
Exchange rate depreciation absorbed part of the shocks on the current account in 2020, dampening the effect of oil price change on the current account balance.

Chart II.1.4 • External public debt and foreign exchange reserves | USD billions



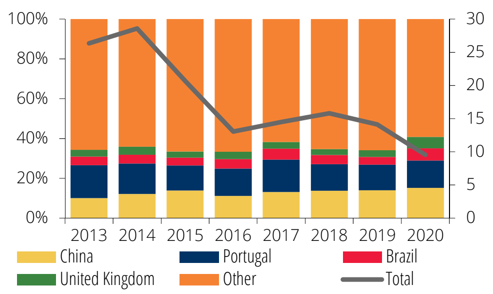
The deterioration in external accounts and the depreciation of the kwanza contributed to the increase in external debt.

Chart II.1.5 • Crude oil exports | Destinations as a %, total in USD billions



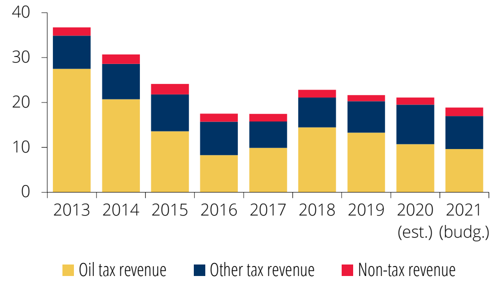
The fall in oil exports reflects the collapse of international prices and production. China has been increasing its weight as the main destination.

Chart II.1.6 • Goods imports | Origins as a %, total in USD millions



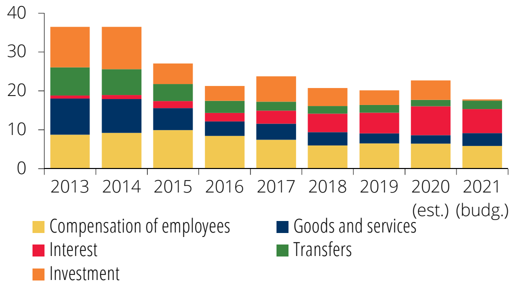
China consolidated its position as the main supplier of goods in 2020. The value of imports has declined again due to the contraction in domestic demand and currency depreciation.

Chart II.1.7 • Public revenue | % of GDP



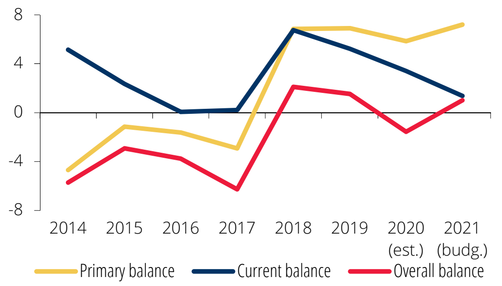
The fragility of the oil sector has been affecting tax revenue. The effort to diversify the economy and broaden the tax base is reflected in the relative growth of non-oil revenue.

Chart II.1.8 • Public expenditure | % of GDP



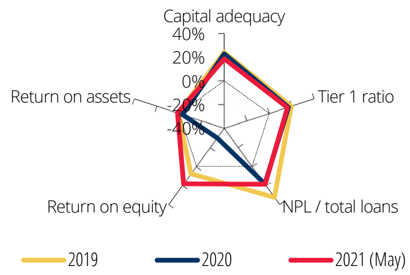
The consolidation measures are evident in the containment of primary expenditure. With an emphasis on the increase in debt burden, which is heavily pressured by currency depreciation.

Chart II.1.9 • Fiscal balances | % of GDP



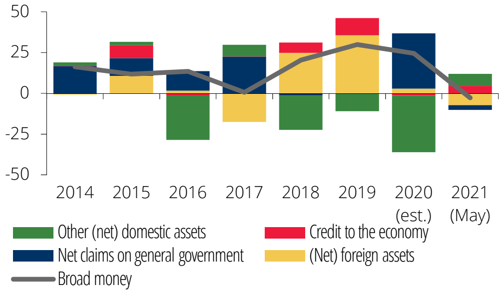
Fiscal consolidation enabled Angola to have a primary surplus since 2018, with developments in interest putting pressure on the overall balance.

Chart II.1.10 • Financial stability indicators



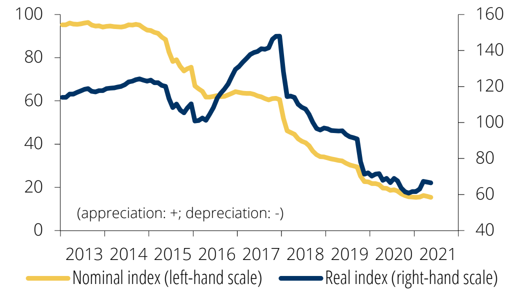
The protracted recession, high inflation and exchange rate depreciation put pressure on asset quality. The fall in the capital ratio in 2020 mainly reflected the losses posted by the largest state-owned bank.

Chart II.1.11 • Liquidity expansion / contraction factors | Changes in % of initial stock of broad money



In 2020, the growth rate in broad money was mainly caused by the increase in net claims on the public sector, limiting the expansion of credit to the economy.

Chart II.1.12 • Effective exchange rates | Indices 100 = 2010, monthly averages



The easing of the kwanza, introduced at the start of 2018 and further developed in 2019, led to considerable gains in external competitiveness.

Table II.1.1 • Main economic indicators

		2018	2019	2020		2021		
				Prog.	Est.	Prog.	Est.	
Output and prices								
Nominal GDP	EUR billions	86.2	74.8	56.4	48.2	53.8	–	
Real GDP	annual % change	-2.1	-0.6	-4.0	-5.2	-0.1	–	
Oil sector	annual % change	-9.5	-6.5	-6.8	-8.0	-7.0	–	
Other sectors	annual % change	1.0	1.8	-2.8	-4.0	2.3	–	
GDP per capita	USD, in PPP(a)	7,100	6,952	–	6,538	–	–	
Inflation (CPI)	year-on-year % change	18.6	16.9	23.1	25.1	18.7	24.9	Jun.
Inflation (CPI)	average % change	19.6	17.1	25.0	22.3	–	24.3	Jun.
Public finances								
Total revenue	% of GDP	22.9	21.7	19.2	21.1	18.9	–	
Oil revenue	% of GDP	14.5	13.3	9.3	10.7	9.7	–	
Total expenditure	% of GDP	20.8	20.1	23.2	22.7	17.9	–	
Current expenditure	% of GDP	16.1	16.4	18.6	17.7	17.5	–	
Investment	% of GDP	4.6	3.7	4.6	5.0	0.4	–	
Overall balance	% of GDP	2.1	1.5	-4.0	-1.6	1.0	–	
External public debt	% of GDP	46.4	59.1	–	90.9	–	101.3	Mar.
Money and credit								
Net foreign assets	annual % change	62.5	66.4	–	4.1	9.6	-12.6	May
Credit to the economy	annual % change	12.4	22.0	–	-3.1	2.1	13.2	May
Broad money (M3)	annual % change	20.4	29.9	–	24.5	15.8	-2.8	May
Interest Rates								
Credit in national currency(b) (180 d)	annual rate	19.8	14.4	–	19.7	–	18.0	May
Deposits in national currency (180 d)	annual rate	10.4	8.0	–	10.1	–	9.4	May
Deposits in foreign currency (180 d)	annual rate	2.2	3.9	–	1.4	–	5.0	May
Standing lending facility	annual rate	16.5	15.5	–	15.5	–	15.5	May
LUIBOR(c) Overnight	annual rate	16.8	22.5	–	9.8	–	13.7	May
Financial stability								
Capital adequacy	%	24.2	24.1	–	22.8	–	18.6	May
NPL/total loans	%	28.3	32.4	–	18.4	–	18.7	May
Return on equity (ROE)	%	26.6	7.8	–	-29.8	–	18.4	May
Balance of payments								
Trade balance	% of GDP	24.6	24.6	15.5	20.7	25.7	–	
Current account	% of GDP	7.3	6.1	-2.4	1.6	5.3	–	
Foreign exchange reserves (gross)	USD billions	16.2	17.2	–	14.9	–	14.1	May
Exchange rates								
EUR/AOA	average rate	297.4	528.3	–	660.8	–	792.1	May
USD/AOA	average rate	252.9	475.4	–	587.1	–	652.2	May
Nominal EERI(d)	annual % change	-43.7	-33.9	–	-31.1	–	-21.0	May
Real EERI(d)	annual % change	-34.5	-25.6	–	-14.5	–	-3.5	May

Sources: Banco Nacional de Angola, Ministry of Finance of Angola, International Monetary Fund and Banco de Portugal calculations. | Notes: (a) Purchasing power parity; (b) Loans granted to enterprises; (c) Luanda Interbank Offered Rate – weighted average rate of liquidity-providing operations without collateral between other monetary financial institutions in the interbank money market; (d) Effective exchange rate index, based on the exchange rates of the main trading partners with variable international trade weights, including exports and imports of goods (appreciation: +; depreciation: -).

2 Cabo Verde

Area 4,033 km^2

Capital city Praia

Population 556,988 (2020; source: Cabo Verde National Institute of Statistics)

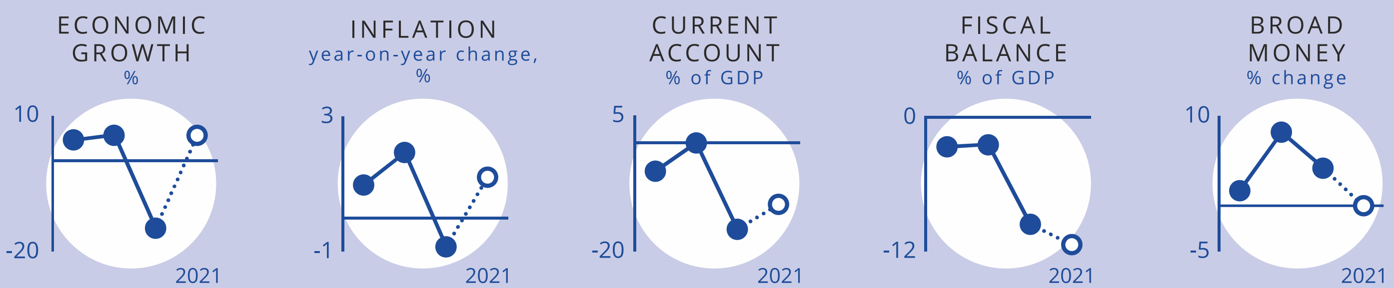
Currency Cabo Verde escudo (CVE)

The impact of the COVID-19 pandemic in 2020 on Cabo Verde was very significant and has extended into 2021. The economy has been severely affected by travel restrictions, which have weighed on activity in the tourism, transport and related activities sectors. The extension of domestic measures to support healthcare sector's response and to support firms, workers and households keeps additional pressure mostly on public finances.

The sharp economic downturn in 2020 was accompanied by a deterioration in the current external and fiscal deficits, interrupting the positive trend observed in previous years. Exports of services (mainly tourism and transport) and goods (mainly re-exports in ports and airports) decreased, partly mitigated by the resilience of emigrants' remittances. The drop in economic activity and the introduction of tax moratoria dampened public revenue, while current expenditure continued to grow, due to the increased costs of fighting the pandemic and its effects as well as the rigidity of expenditure. Pandemic-driven additional financing needs for public and external accounts led authorities to seek for support from international institutions as well as to resort to domestic credit, thus adding to public indebtedness.

The outlook outlined by national authorities for 2021 points to 5.5% growth, with an expected resumption of tourism in the last quarter of the year, dampening pressure on the balance of payments and, in part, on public accounts. Controlling the pandemic, which is also conditional on the swiftness of the vaccine rollout, in both Cabo Verde and its main partners, poses the main risk to this scenario. This growth scenario may be hampered if the rebound in tourism and related sectors fails to materialise, with consequences for fiscal and external deficits.

In April 2020, Cabo Verde benefited from IMF resources through the Rapid Credit Facility, while the programme under the Policy Coordination Instrument (without financial assistance) was successfully completed in April 2021.



The impact of the COVID-19 pandemic marked macroeconomic developments in Cabo Verde from March 2020 onwards, leading to a 14.8% contraction in output in 2020. This trend continued in early 2021, with a further real drop in economic activity in the first quarter, estimated at 11% year on year. Measures to contain the spread of the virus led to travel bans, greatly hampering tourism and related activities, which are the country's main growth drivers. Expectations of a resurgence in tourism flows in the final quarter of the year fed into projections of 5.5% growth in economic activity for 2021 as a whole. The adverse scenario limits growth to 3%, considering continued difficulties in the tourism sector.

After being highly stable for three years, inflation followed a downward path from mid-2020 onwards, edging down to average rates of virtually zero in March and April and figures close to -1% year on year. The good agricultural year, particularly fresh food, contributed to this situation, which was reflected in price developments for food and non-alcoholic beverages. Rising commodity prices, particularly energy, were the main factor behind the reversal of the path observed in the second quarter of 2021, although authorities expect inflation to remain below 2% throughout the year.

The near standstill of the tourism sector has had a negative direct effect on the current account, reaching a deficit of 15.9% of GDP in 2020, after being virtually nil in 2019. In addition to the large reduction in services exports, including transport revenue, exports of goods were also badly affected, given that a large share corresponds to re-exports in ports and airports. The deterioration in the current balance was mitigated by a contraction in imports, stemming from lower economic activity, and the resilience of emigrants' remittances. These trends continued during the first months of 2021, although projections for the year as a whole point to a reduction in the current deficit, to 11.4% of GDP, in light of the expected pick-up in tourism in the final quarter.

Reserves have been decreasing since August 2020, ending the year with a stock of EUR 579 million (down by EUR 82 million from December 2019), despite the foreign direct investment inflows and disbursements of external loans to the State. This trend continued in 2021, with a loss of over EUR 59 million by May. With imports also declining, reserve coverage is still robust: the stock for May 2021 (EUR 520 million) stood at 6.8 months' worth of imports of goods and services forecast for the year as a whole, preserving some room for the sustainability of the exchange rate peg to the euro.

Difficulties spilled over into public accounts, in view of decreasing revenues and pressure on expenditure. The fiscal deficit increased to 9.5% of GDP in 2020 (2.4% in 2019) and a further increase is expected in 2021 (to 11.3%). There was a decrease in tax collection (due to the decline in economic activity and tax moratoria) and non-tax revenue (most notably, port and airport fees), as well as a reduction in grant inflows, mainly for budget support. In turn, there was an increase in spending on measures to contain the pandemic (treatment and vaccination) and to mitigate the impact on households and firms (State-guaranteed credit lines, 'layoff' scheme, allowance for people in quarantine, employment benefits, among others). However, efforts were made to contain non-essential expenditure and the reduction in interest, due to the moratoria on external debt servicing obligations under the Debt Service Suspension Initiative, as well as the issuance of Treasury bonds at more favourable rates.

Public financing requirements to cover the deficit and transactions in financial assets (including participating interests in State-owned enterprises and loans passed on to public entities) have been met through external and domestic financing. The State has resorted to support from international and regional financial institutions, through loans from the World Bank, the IMF and the African Development Bank. Taking advantage of more favourable rates, the issuance of Treasury securities placed with the domestic market has also been substantial. Public debt thus grew markedly in 2020, to 155% of GDP, a trend which continued into 2021, with estimates pointing to 157% of GDP at the end of the year.

The behaviour of broad money has been conditioned by developments in the external position of the banking system, given the erosion of the official foreign reserves and the unwinding of banks' holdings of demand deposits abroad. However, credit to general government (with the issues of

Treasury securities) and credit to the private sector (boosted by State-guaranteed credit lines) have contributed to a decline in the system's excess liquidity. Particularly since early 2021, excess reserves and access to the absorption facility have decreased (lower amounts and less frequent operations). The expected contraction in broad money in 2021 is also related to the transfer of *Títulos Consolidados de Mobilização Financeira* (consolidated financial mobilisation securities, i.e. public debt securities guaranteed by resources based in a Trust Fund managed abroad) held by the Banco de Cabo Verde (BCV) to the National Social Security Institute (CVE 4.6 billion).

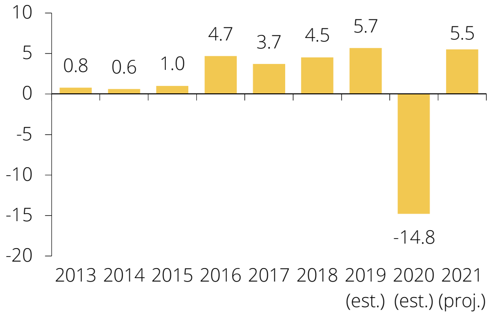
As part of the efforts in support of firms' liquidity, the Banco de Cabo Verde also took measures in 2020 to foster lending by the banking system, more specifically cuts in rates on its instruments (including reserve requirements), the establishment of a new longer-term liquidity-providing instrument, a decrease in the capital adequacy ratio and a disregard of moratoria for prudential requirements and activity ratios of banking institutions. The BCV plans to preserve accommodative conditions throughout 2021, provided that inflation levels remain low and stable.

The increased activity in the banking sector has been accompanied by an improvement, year on year, of the capital adequacy ratio and the non-performing loans ratio, without hampering profitability. In terms of funding, reference should be made to the pace of growth of emigrant deposits, faster since early 2021, and the gradual increase in recourse to monetary financing operations (long-term financing of banks, at a 0.75% rate), with an outstanding amount of nearly CVE 6 billion at the end of May 2021.

In April 2021, Cabo Verde successfully concluded the programme with the IMF under the Policy Coordination Instrument (without financial assistance). However, to cover balance-of-payments needs stemming from the impacts of the pandemic, Cabo Verdean authorities benefited in April 2020 from IMF resources through the Rapid Credit Facility, totalling USD 32.3 million.

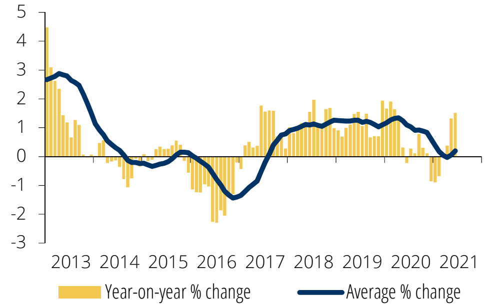
Although the global vaccination process is progressing, in both Cabo Verde and its main partners, uncertainty is high. There is still a major risk of an extension of the pandemic situation, which would clearly constrain the pick-up in economic activity, affecting public and external accounts.

Chart II.2.1 • Real GDP | Annual % change



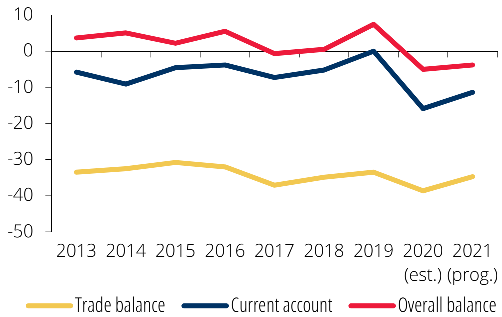
The pandemic had severe effects on Cabo Verde, leading the economy into a substantial contraction in 2020. Forecasts point to a recovery in 2021, to close to previous paces of growth, based on the pick-up in tourism in the final quarter.

Chart II.2.2 • Inflation | Annual % change in the CPI



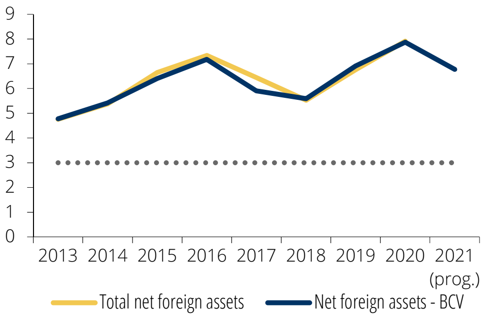
After being stable for a number of years, inflation rates started on a downward path in mid-2020, on the back of a good agricultural year. The increase in energy prices in 2021 reversed that trend, although to controlled levels.

Chart II.2.3 • Balance of payments | % of GDP



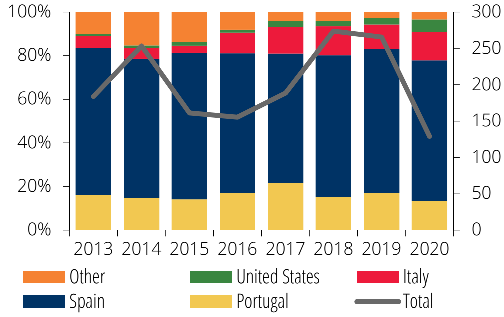
Travel restrictions affected tourism and related activities, leading to a worsening of the current account in 2020. The expected resumption of tourism travel should improve external accounts in 2021.

Chart II.2.4 • Foreign exchange reserves | Months of goods and services imports



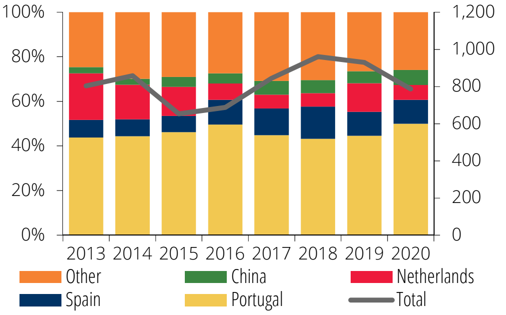
Despite the deterioration in external accounts, the coverage of imports by foreign exchange reserves is still robust. Lower activity generates fewer imports, making it possible to ensure a coverage of 6.8 months at end-2021.

Chart II.2.5 • Goods exports | Destinations as a %, total in USD millions



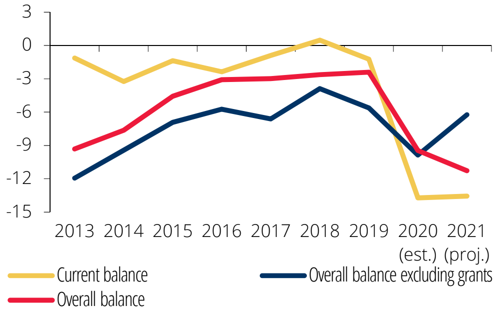
Despite a decrease, the geographical structure of Cabo Verdean exports remained virtually unchanged in 2020, with Spain, Portugal and Italy, as a whole, accounting for 91% of the total.

Chart II.2.6 • Goods exports | Origins as a %, total in USD millions



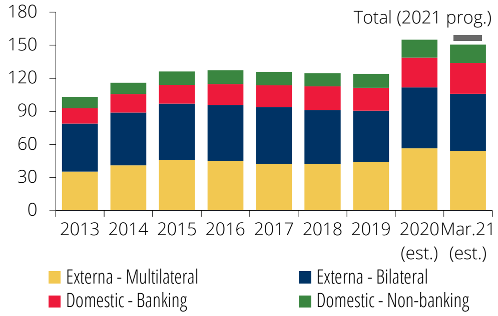
Cabo Verde an imports originated from a small group of markets, with Portugal, Spain and the Netherlands providing 67% of imported products in 2020, although China has been progressively gaining ground.

Chart II.2.7 • Fiscal balances | % of GDP



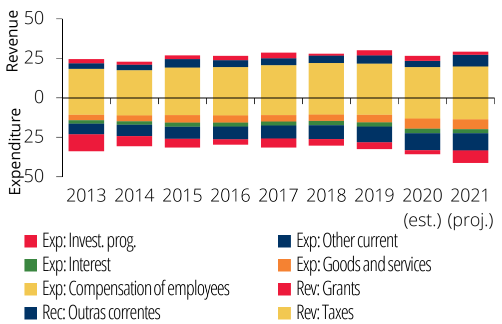
The reduction in public revenue and the pressure on expenditure due to the pandemic interrupted the efforts to consolidate public accounts observed up to 2019, resulting in a decline in fiscal balances.

Chart II.2.8 • Public debt | % of GDP



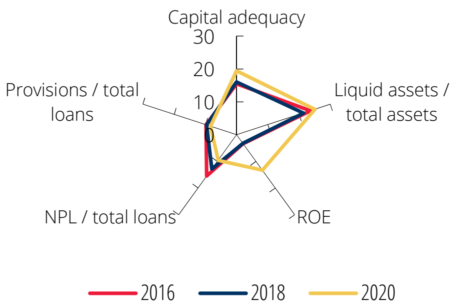
The additional financing needs caused by the pandemic crisis called for authorities' efforts, leading to a hike in total public debt, which is expected to reach close to 157% of GDP in 2021.

Chart II.2.9 • Public revenue and expenditure | % of GDP



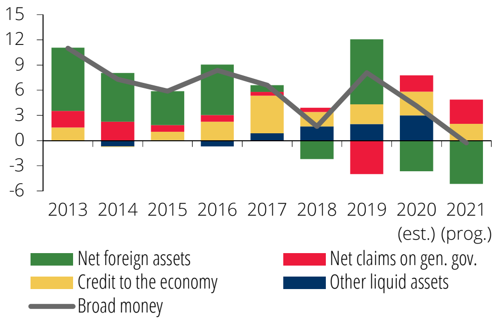
Lower activity and tax moratoria decreased tax collection, followed by lower non-tax revenue and grants. The fight against the pandemic increased current expenditure, in spite of the restraint introduced.

Chart II.2.10 • Financial stability indicators | %



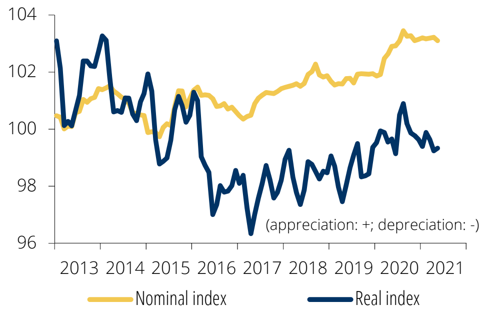
The momentum in credit has boosted activity in the banking sector, which has posted better solvency and non-performing loans ratios, without hampering profitability.

Chart II.2.11 • Liquidity expansion/contraction factors | Changes in % of initial stock of broad money



More buoyant credit to the economy and the public sector offset the deterioration in the external position in 2020. In 2021, domestic credit growth will not be enough to prevent a contraction in broad money.

Chart II.2.12 • Effective exchange rates | Indices 100 = 2010, monthly averages



Since mid-2020 the nominal effective exchange rate of the CVE has remained stable, but with a tendency to depreciate in real terms, in light of the narrowing of inflation spreads against European and Chinese levels.

Table II.2.1 • Main economic indicators

		2018	2019 Est.	2020 Prog.	2020 Est.	2021 Prog.	2021 Est.	
Output and prices								
Nominal GDP	EUR millions	1,666	1,770	1,666	1,496	1,593	–	
Real GDP	annual % change	4.5	5.7	-6.8	-14.8	5.5	5.6	H1
GDP per capita	USD, in PPP(a)	7,029	7,471	–	6,424	–	–	
Inflation (CPI)	year-on-year % change	1.0	1.9	1.3	-0.9	1.2	1.5	Jun.
Inflation (CPI)	average % change	1.3	1.1	1.3	0.6	1.2	0.2	Jun.
Public finances								
Total revenue	% of GDP	27.9	30.1	29.2	26.5	29.2	–	
Grants	% of GDP	1.3	3.2	4.4	3.1	2.0	–	
Total expenditure	% of GDP	30.4	32.5	40.5	35.8	41.2	–	
Overall balance	% of GDP	-2.6	-2.4	-11.4	-9.5	-11.3	–	
Public debt	% of GDP	124.7	124.1	145.8	154.9	156.6	150.6	Mar.
External	% of GDP	91.4	90.6	107.1	111.6	112.1	105.9	Mar.
Domestic	% of GDP	33.3	33.5	38.7	43.3	43.7	44.7	Mar.
Money and credit								
Net claims on general government	annual % change	2.9	-22.4	-25.9	15.1	20.3	-9.1	May(b)
Credit to the economy	annual % change	2.8	3.9	4.7	4.8	3.4	2.3	May(b)
Broad money (M3)	annual % change	1.7	8.1	-6.3	4.1	-0.3	-1.5	May(b)
Interest rates(c)								
One-year deposits (average of OMIs)	annual rate	2.4	2.0	–	1.5	–	1.5	May
Lending facility	annual rate	4.5	3.0	–	0.5	–	0.5	Jun.
Treasury bills (91 days)	annual rate	1.0	1.1	–	–	–	1.0	Feb.
Financial stability								
Capital adequacy(d)	%	16.1	17.7	–	19.4	–	19.6	Mar.
NPL / total loans	%	12.9	10.8	–	9.6	–	10.3	Mar.
Return on equity (ROE)	%	3.2	16.6	–	13.3	–	–	
Balance of payments								
Current account	% of GDP	-5.3	0.0	-15.0	-15.9	-11.4	–	
Current and capital accounts	% of GDP	-4.5	0.5	-14.0	-14.8	-10.7	–	
Official reserves	months of imports(e)	5.6	6.9	7.0	7.9	6.8	6.8	May
Exchange rates								
EUR/CVE	average rate	110.3	110.3	110.3	110.3	110.3	110.3	Jun.
USD/CVE	average rate	93.4	98.5	100.6	96.8	90.5	90.9	May
Nominal EERI(f)	annual % change	0.4	0.1	–	1.2	–	0.0	May(b)
Real EERI(f)	annual % change	0.3	0.9	–	0.3	–	-0.3	May(b)

Sources: Banco de Cabo Verde, Ministry of Finance of Cabo Verde, Cabo Verde National Institute of Statistics, International Monetary Fund and Banco de Portugal calculations. | Notes: (a) Purchasing power parity; (b) Change from the previous December; (c) Monthly averages (corresponding to December for annual figures); (d) Regulatory capital/risk-weighted assets; (e) Imports of goods and services; (f) Effective exchange rate index, based on the exchange rates of the main trading partners with variable international trade weights, including exports and imports of goods (appreciation: +; depreciation: -).

3 Guinea-Bissau

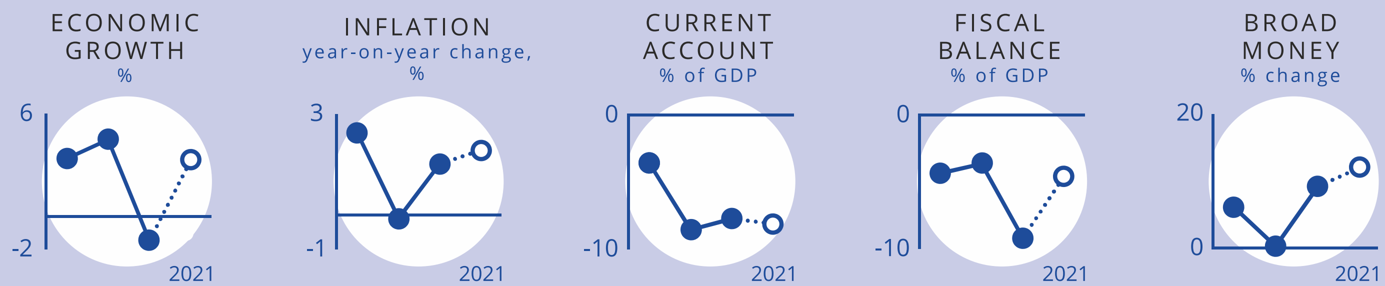
Area 36,125 km²
Capital city Bissau
Population 1.9 million (2020; source: UN)
Currency CFA franc (XOF)

Sustained and inclusive economic growth in Guinea-Bissau has suffered several setbacks in recent years. The country's institutional framework has constrained the implementation of structural reforms, investment in key infrastructures, human capital retention and private sector growth. Economic development is also limited by its productive structure, which depends heavily on exports of unprocessed cashew nuts (in 2020 these accounted for 96% of exports), a sector particularly exposed to climate risks and international market conditions. The volatility of annual growth rates reflects these factors, affecting developments in GDP per capita, which have shown an average annual rate of change of less than 1% between 2000 and 2019.

The pandemic coincided with the aftermath of the 2019 presidential electoral dispute. The electoral deadlock was overcome in June 2020 with the approval of the new Government's programme, supported by the Economic Community of West African States. In 2020, the fall in external demand and the international price of cashew, the measures to fight the social and health emergency, and the September floods led to an estimated 1.4% drop in output, a decline in the external accounts, a deterioration of the fiscal balance and an increase in public debt.

Disruptions caused by the pandemic and floods are expected to continue to constrain economic growth in 2021, given the small size of the financial sector and the economy's high degree of informality. The Government's agenda is focused on fiscal consolidation, debt sustainability, strengthening public governance and fighting corruption. In support of these policies, in July 2021 the authorities reached an agreement with the IMF on a 9-month Staff Monitored Program, with a view to a potential arrangement under the Extended Credit Facility in 2022.

Containing the epidemic outbreak and political stability are key factors for growth prospects of Guinea-Bissau's economy. The recent stabilisation of the political situation and the country's re-association with the international community has catalysed the mobilisation of external support and concessional financing, which are essential to ensuring debt sustainability, the implementation of structural reforms and the fight against poverty.



The COVID-19 pandemic and floods that hit the country in 2020 worsened the population's poverty and inequality indices. In 2020, a fall of 1.4% in GDP is estimated, compared with 0.3% growth in the West African Economic and Monetary Union (WAEMU), with the cashew sector suffering from a collapse in international demand and prices and delays in launching the campaign due to restrictions on movement and border closures. Similarly, measures to contain the pandemic led to a contraction in domestic demand, weighing on consumption, employment and investment. The September floods exacerbated disruptions in economic activity, notably the agricultural sector and infrastructures.

The pandemic's positive developments, the recovery of international trade and the stabilisation of the political situation were the main drivers of economic recovery in 2021. The cashew nut export sector will probably benefit from stimulating demand and a higher international price. In addition, the gradual lifting of containment measures has contributed to boosting domestic demand, alongside the contribution by stabilising the political situation to the economy's financing conditions. The IMF projects a 3.3% GDP expansion in 2021, with year-on-year growth estimated at 2.7% in the first quarter.

Inflation remains anchored, despite pressure from disruptions in international trade and monetary policy stimuli. Prices accelerated in 2020, with the year-on-year inflation rate rising from -0.1% in 2019 to 1.5% in 2020. Food prices, mostly imports, appear to be the main driver of price growth. Year-on-year inflation is projected at 1.9% in 2021, reflecting the recovery in domestic demand, food price developments and, to a lesser extent, international oil prices.

The difficulties imposed by the pandemic induced the deterioration of the external accounts in 2020, leading to financing needs. The collapse in demand and the international price of cashew led to a 22% fall in exports of goods, while imports of goods showed a rigidity in line with the maintenance of essential consumption, particularly food and medicines. The current account deficit of 7.6% of GDP (8.4% in 2019) is the result of a widened trade deficit, partly offset by an increase in emigrants' remittances of 3 p.p. of GDP. There was an overall external deficit of 2.3% of GDP, which mainly reflects the contraction in foreign direct investment and largely financed by the sale of international reserves.

In 2021, an external deficit of 0.8% of GDP is estimated, with strong import dependency limiting the balance adjustment margin. In addition to essential consumer goods, demand for capital and intermediate consumption goods needed to strengthen the health sector and recover infrastructures, as well as increased international oil prices, will weigh on the external accounts. Recovery in exports, driven by stimulating demand and international prices of cashew, will not suffice to prevent a current account deficit, projected at 8% of GDP in 2021. Access to the IMF's Rapid Credit Facility (RCF) will ensure financing of 35% of the external deficit, with additional concessional financing being expected from other multilateral organisations and bilateral donors.

Measures to fight the economic and health crisis and negative growth weighed on public accounts in 2020, with an estimated overall balance of -9.1% of GDP and a primary balance of -7.7% of GDP. Current revenue declined by 0,7 p.p., to 11.2% of GDP, affected by the fall in collecting revenue from exports of cashew nuts and sales taxes on imported goods (a 15% and 32% revenue in 2019 respectively), plus the effect that restricting movement had on tax compliance. In turn, the pandemic imposed an increase in expenditure, by 3.4% of GDP, to address the health and economic emergency, in addition to the financing programme for the cashew campaign, which amounted to 1.8% of GDP. Deterioration in the fiscal situation originated estimated financing needs of 5.2% of GDP, worsening the public debt ratio by 9 p.p., to 72% of GDP. The Government benefited from concessional external financing, notably fiscal support granted by the World Bank, the Islamic Development Bank and access to the IMF's Catastrophe Containment and Relief Trust. The Government also used the WAEMU market, including Treasury issuances with commercial banks at non-concessional rates, which increased the cost of debt.

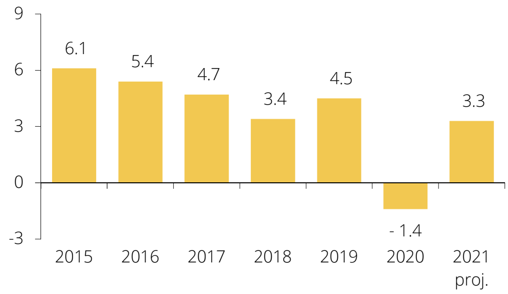
In 2021, the Government took on a strategy of fiscal consolidation through measures aimed at mobilising tax revenue and rationalising current expenditure, especially wages. The Government intends to reduce the tax deficit to 3% of GDP by 2025 and the public debt ratio to 70% of GDP by 2026, in line with the currently suspended WAEMU convergence criteria. The 2021 budget projects a 4.6% headline deficit, a 2.6% primary deficit and a rise in the public debt ratio by 6 p.p., to 78% of GDP. A core element of the Government's sustainability strategy is the pressure relief from non-concessional financing in the WAEMU market. The stabilisation of the political situation, the strategy of reconnecting with the international community and the recent agreements with the IMF have strengthened the economy's external credibility and catalysed external concessional financing. This includes the RCF agreed with the IMF, fiscal support already guaranteed with the World Bank, the African Development Bank and the French government, as well as joining the Debt Service Suspension Initiative.

There was a reaction from the monetary policy intended to dispel concerns about liquidity shortages, with the Central Bank of West African States (BCEAO) meeting all the needs expressed by the banks within the refinancing opportunities at a single rate of 2%, and it additionally extended the collateral framework to assets from non-financial corporations. Disruption in economic activity has caused liquidity and compliance pressures in the credit market, partly mitigated by regulatory adjustments and moratoria. In view of the impact on public finances, access to WAEMU's financial market was ensured at low cost, while Member States were waiting for financing to be mobilised by external partners.

The economic slowdown and increased uncertainty intensified the weaknesses of the banking system, exerting pressure on the quality of the asset portfolio. The low capital ratio of the banking system reflects the lack of capital of one systemically important bank, despite the recapitalisation process carried out by the Government in 2019. Credit to the economy grew modestly in 2020, despite the impact of political instability on the financing usually provided to farmers and exporters before the cashew campaign. Liquidity provided by the BCEAO appears to have prevented an abrupt contraction in credit to the economy, while allowing the build-up of net assets in the banking sector through the purchase of sovereign bonds in the WAEMU market.

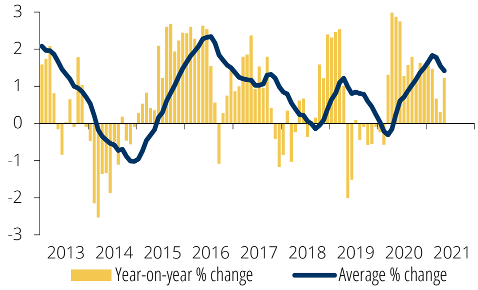
The main risks for Guinea-Bissau's economy are the persistence of the health crisis and an upsurge of political instability against a background of high public debt. Containing the epidemic and a successful vaccination campaign should contribute to stimulating domestic demand and a good cashew campaign. The easing of Guinea-Bissau's political situation contributes to containing the risk of worse social tensions, which is crucial for implementing a fiscal and structural reform plan. In the medium term, economic growth will also depend on mobilising external support – particularly negotiations with the IMF – which is key to implementing structural reforms, including infrastructure investment, and for the sustainability of public debt.

Chart II.3.1 • Real GDP | Annual % change



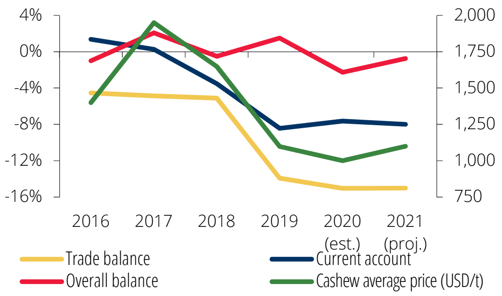
The COVID-19 pandemic and floods had a heavy impact on economic activity in 2020, halting its growth. A gradual recovery is expected in 2021.

Chart II.3.2 • Inflation | Annual % change in the CPI



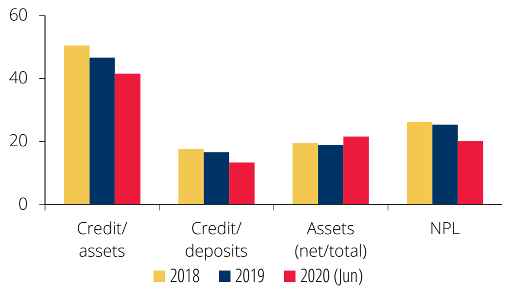
Inflation remained anchored despite inflationary stimuli. Acceleration in prices in 2020-21 reflects the rise in import prices of essential consumer goods.

Chart II.3.3 • Balance of payments and cashew prices | % of GDP, average cashew price per tonne in USD



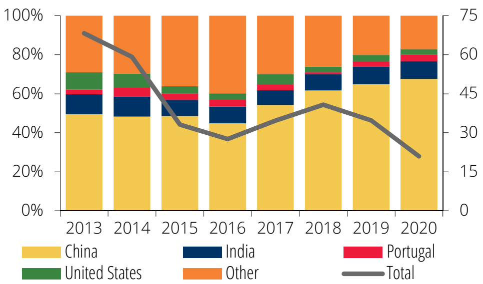
The current account balance depends on the international price of cashew, revealing the fragility of the Guinean productive sector.

Chart II.3.4 • Financial stability indicators, %



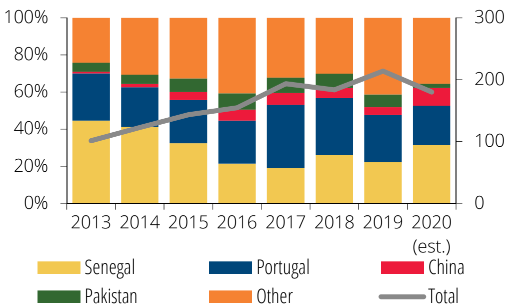
The BCEAO's liquidity-providing policies allowed the banking sector to build-up net assets relative to credit growth.

Chart II.3.5 • Goods exports | Destinations as a %, total in billions of CFA francs



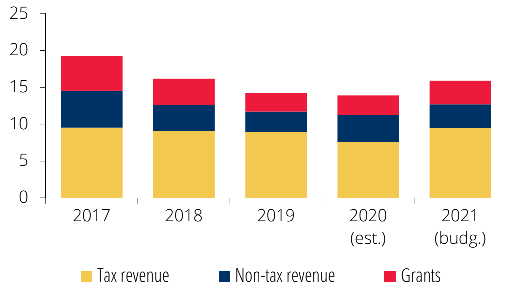
The fall in prices and demand for cashew has led to a contraction in exports. India, which has a processed cashew export sector, is the main destination for exports.

Chart II.3.6 • Goods exports | Origins as a %, total in billions of CFA francs



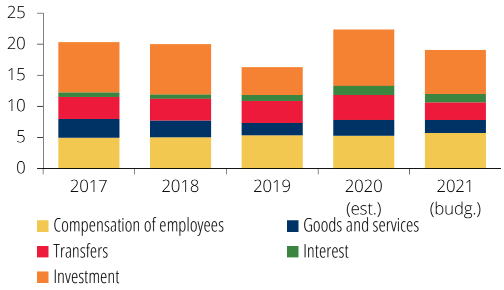
The slight fall in imports in a context of a sharp drop in activity reflects the rigidity in the consumption of essential goods and the fall in international oil prices.

Chart II.3.7 • Public revenue | % of GDP



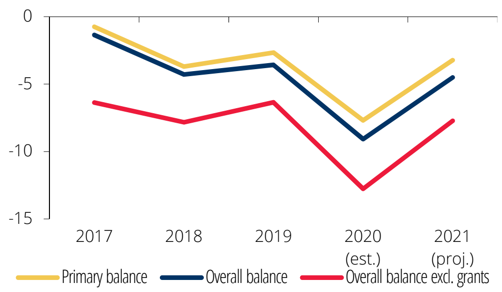
In 2020, the recession explained the fall in revenue, also affected by the restrictions on movement necessary for tax compliance.

Chart II.3.8 • Public expenditure | % of GDP



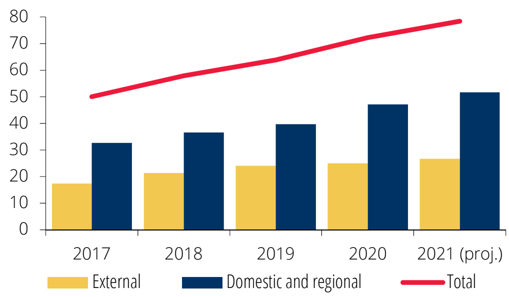
Rigidity in public wages limits fiscal adjustment. The levels of public investment have been maintained thanks to multilateral external financing.

Chart II.3.9 • Fiscal balances | % of GDP



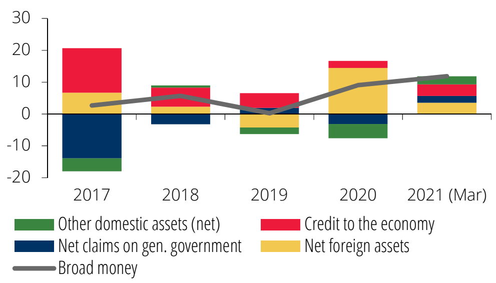
The fall in revenue and increased expenditure due to the health emergency aggravated public accounts. Fiscal space depends heavily on external support.

Chart II.3.10 • Public debt | % of GDP



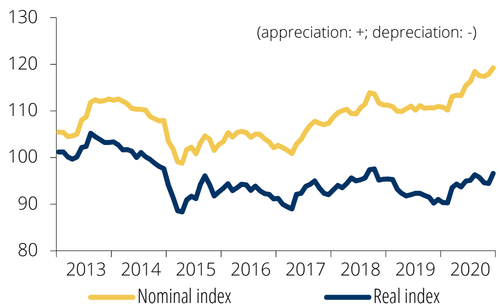
The widening of the budget deficit is reflected in higher public indebtedness. Growing dependency on non-concessional domestic and regional financing increased the cost of debt service.

Chart II.3.11 • Liquidity expansion / contraction factors | Changes in % of initial stock of broad money



In 2020, broad money growth reflects the BCEAO's liquidity-providing policies, allowing the build-up of net foreign assets and the resilience of credit to the economy.

Chart II.3.12 • Effective exchange rates | Indices 100 = 2010, monthly averages



The devaluation of the Indian rupee against the CFA franc is the main factor in the loss of external competitiveness of Guinea-Bissau's economy.

Table II.3.1 • Main economic indicators

		2018	2019	2020		2021	
			Est.	Prog.	Est.	Prog.	Est.
Output and prices							
Nominal GDP	EUR millions	1,303	1,349	1,218	1,364	1,422	–
Real GDP	annual % change	3.4	4.5	-1.9	-1.4	3.3	–
Output per capita	USD, in PPP(a)	1,948	2,021	–	1,949	–	–
Inflation (CPI)	year-on-year % change	2.4	-0.1	1.1	1.5	1.9	1.2 May
Inflation (CPI)	average % change	0.4	0.2	0.8	1.5	–	1.4 May
Public finances							
Total revenue	% of GDP	15.1	14.7	13.7	19.7	14.2	–
Total expenditure	% of GDP	19.3	18.3	25.0	25.2	22.9	–
Overall balance	% of GDP	-4.3	-3.6	-11.4	-9.1	-4.5	–
Overall balance excluding grants	% of GDP	-7.8	-6.3	-15.7	-12.8	-7.7	–
Public debt	% of GDP	57.9	63.8	–	72.2	78.4	–
External	% of GDP	21.4	24.1	–	25.0	26.7	–
Domestic and regional	% of GDP	36.6	39.7	–	47.2	51.7	–
Money and credit							
Net claims on general government	annual % change	-18.7	13.8	2.8	-19.7	–	18.1 Mar.
Credit to the economy	annual % change	21.5	13.8	2.1	5.9	–	10.0 Mar.
Broad money (M2)	annual % change	6.1	0.3	1.2	9.1	–	11.9 Mar.
Interest rates							
Deposit, 6 months to 1 year	annual rate	4.0	4.0	–	3.0	–	–
Lending, 6 months to 1 year	annual rate	8.6	7.3	–	6.6	–	–
Financial stability							
Capital adequacy(b)	%	-5.4	-2.0	–	-2.6	–	–
NPL/total loans(b)	%	26.3	25.4	–	20.3	–	–
Return on equity (ROE)	%	17.2	79.6	–	–	–	–
Balance of payments							
Current account	% of GDP	-3.5	-8.4	-12.7	-7.6	-8.0	–
Current account excl. official transfers	% of GDP	-4.7	-9.6	-9.9	-8.9	-10.7	–
Exchange rates							
EUR/CFA franc	average rate	656.0	656.0	656.0	656.0	–	656.0 Jun.
USD/CFA franc	average rate	555.7	586.0	–	575.6	–	544.5 Jun..
Nominal EERI(b)	annual % change	3.6	-0.2	–	7.5	–	–
Real EERI(b)	annual % change	3.6	-4.5	–	6.1	–	–

Sources: BCEAO National Directorate for Guinea-Bissau, International Monetary Fund, Banco de Portugal calculations and European Central Bank. | Notes: (a) Purchasing power parity; (b) Data for 2020 refer to June; (c) Effective exchange rate index, based on the exchange rates of the main trading partners with variable international trade weights, including exports and imports of goods (appreciation: +; depreciation: -).

4 Mozambique

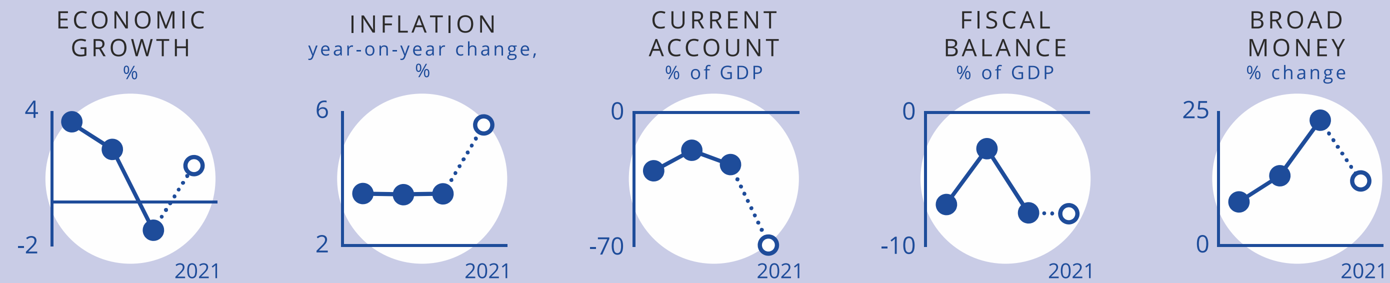
Area 799,380 km²
Capital city Maputo
Population 31.3 million (2020; source: United Nations)
Currency Metical (MZN)

The drop in external demand and the effect of the COVID-19 pandemic control measures on productive activity and consumption explain the 1.2% contraction in output in 2020. This follows a prolonged period of economic slowdown, triggered by the 2015-16 adverse shocks and the devastating effect of the 2019 tropical cyclones. The pandemic crisis has brought to the fore the vulnerabilities of a model of economic growth that is highly exposed to global shocks, given its high dependence on megaprojects and commodity exports.

Aware of the weaknesses of the Mozambican health system to tackle the health emergency, the Government swiftly implemented social distancing rules, restrictions on mobility, and promoted rules to prevent contagion from the end of March 2020. At the same time, in anticipation of the economic and social costs of the pandemic crisis, fiscal, monetary and macroprudential support measures for the economy were put in place and urgent international financial support was requested in April 2020 to limit the deterioration of fiscal and external balances. By the end of January 2021, the Mozambican authorities had received USD 669 million, of which 309 concerned the IMF's Rapid Credit Facility disbursement, and benefited from the debt relief programmes under the IMF's Catastrophe Containment and Relief Trust and the G20's Debt Service Suspension Initiative.

The fall in fiscal revenue and the increase in defence and security expenditure reduced an already limited fiscal policy space and led to an increase in public debt in 2020. By contrast, price stability achieved in recent years allowed further monetary easing, while safeguarding lending to the economy and mitigating the deterioration in credit quality.

According to the IMF projections for 2021, the economic recovery is expected to continue at a slow pace, mainly dependent on three risk factors, which had already materialised in the first half of 2021 and persist over the analysis horizon: the COVID-19 pandemic, armed conflicts and adverse weather events.



Economic activity contracted by 1.2% in 2020, reflecting the decline in activity in the mining and quarrying sector, owing to the drop in external demand and the decrease in commodity prices, particularly in the first half of the year. The manufacturing, trade and services sectors posted significant declines in activity due to decreasing domestic demand, partly caused by mobility restrictions and social distancing measures necessary to control the pandemic. Most affected was the accommodation and food sector, which contracted by 22.1% in 2020. The positive contributions from the agricultural sector – benefiting from favourable weather conditions in 2020 – and electricity production are noteworthy. In the first quarter of 2021, output grew by 0.1% compared with the same period a year earlier, owing to contributions from the agricultural, financial services and public administration sectors, while the sectors most affected by the pandemic continued to record declines in activity similar to those observed in the previous year.

Positive developments in overall demand driven by fiscal stimulus programmes and progress achieved in vaccination campaigns, especially in developed economies, are likely to support the recovery in revenue from the main commodities exported by Mozambique (price and volume effect), thus contributing to the economy's return to positive growth from 2021 onwards (from 1.6% of GDP according to IMF projections).

Inflation remained stable throughout 2020: the average annual rate was 3.1% compared with 2.8% in 2019, despite the nominal depreciation of the metical (with a 14 p.p. decline in the nominal effective exchange rate between March and December 2020). However, inflation developments in the first half of 2021 and short- and medium-term projections raise expectations of an increase in the average price level in 2021. This trend is the result of increases in food prices (due to the impact of the cyclones that hit the country's central region in late December 2020 and January 2021) and international prices of the main imported commodities (such as oil and cereals), which are expected to persist in the medium term. The year-on-year rate of inflation is expected to rise from 3.5% in 2020 to 5.5% in 2021. These projections include risks that could heighten the inflationary pressures mentioned above, notably risks associated with increased public financing needs, stemming from a third wave of COVID-19 or worse security conditions in the country.

Although the late approval of the 2020 State Budget made it possible to partially anticipate the effects of the pandemic, an amending budget had to be prepared in November. The main amendments resulted in: (i) a reduction in tax revenue, in line with the revision of macroeconomic assumptions and tax measures implemented under the COVID-19 response plan; (ii) increased expenditure related to the pandemic, such as support granted to businesses and current transfers to households, and related to other areas such as education, infrastructure, agriculture, transport, and defence and security; and (iii) increased external resources from disbursements of cooperation partners' commitments to prevent and combat the pandemic. At the end of 2020, the overall budget balance, excluding grants, reached -11.3% of GDP, a figure explained by the deterioration in the current balance to 0.6% of GDP (a fall in revenue of 4.9 p.p. of GDP and an increase in expenditure by 2.4 p.p. of GDP). Including grants, the overall budget balance was -7.7% of GDP (-2.8% of GDP in 2019).

Mozambican public debt reached 92.2% of GDP at the end of 2020, increasing by 11.9 p.p. from the end of 2019. In the same period, domestic public debt rose from 16.3% to 20.1% of GDP, with a 27.4% increase in the stock of Treasury bonds. External public debt increased from 64% of GDP at the end of 2019 to 72.2% of GDP at the end of 2020. According to the IMF assessment (April 2020), Mozambique remains over-indebted but sustainable, taking into account the projected increase in general government revenue from 2023 onwards arising from the exploitation of State-owned natural gas projects in the north of the country.

Pressure on public finances will persist in 2021. Expenditure on the COVID-19 vaccination campaign, social transfers to mitigate the effects of cyclones and spending on defence and security is expected to increase. On the revenue side, the negative effect of less dynamic economic activity and reduced employment was particularly important, especially in view of the suspension of activity of a natural gas project in the Rovuma basin following the upsurge in insurgency in Cabo Delgado Province at the end of March 2021. Progress achieved in restoring security in the most affected areas from August onwards is expected to have a limited impact on public accounts by the end of the year. Increased expenditure on investment and social support is anticipated, aiming at creating the conditions for the return of refugees and the resumption of industrial activity.

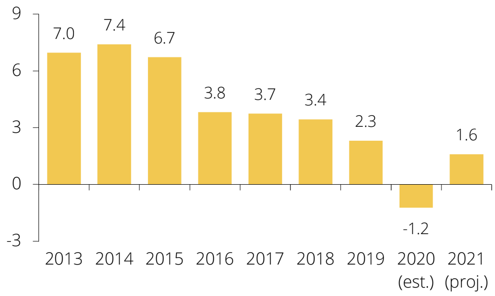
The recovery in commodity prices and external demand in 2020, particularly in the second half of the year, coupled with the disruption in domestic activity, brought the trade balance to -16.3% of GDP in 2020 (a 2.8 p.p. decrease from 2019). Developments in the trade balance and the rise in the external debt burden contributed to deteriorating the current account deficit, which reached 27.1% of GDP in 2020 (an increase of 7.5 p.p. of GDP from 2019). Despite the increase in foreign direct investment (to 17% of GDP in 2020), net external financing needs amounted to 3.2% of GDP in 2020 and were met by resources raised from international institutions and cooperation partners (resulting in the accumulation of gross reserves, estimated at 7 months of imports of goods and services, excluding megaprojects, at the end of 2020).

The trade deficit is expected to improve in 2021, in line with the recovery in overall demand and the continued recovery in export commodity prices, an expectation dependent on the evolution of the pandemic in some of Mozambique's main trading partners. Maintaining favourable financing conditions in international markets, exchange rate stability and restoring investor confidence will be key factors in safeguarding access to external financing.

The monetary policy response to the pandemic crisis resulted in a further easing of financing conditions, as the reduction in the policy rate (MIMO rate) shows. Broad money posted a 23.6% net annual growth, the greatest since 2013, corresponding to the increase in net foreign assets (19.4%), claims on general government (14.1%, in gross terms) and credit to the economy (7.4%). At the end of January 2021, in view of the rising inflation prospects, the Banco de Moçambique began the process of reversing accommodative monetary policy conditions, raising the MIMO rate by 300 basis points to 13.25%, with the rise in market interest rates being already noticeable.

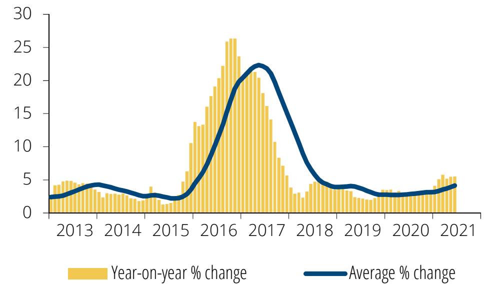
The capital and liquidity ratios of the banking sector remained at stable and adequate levels at the end of 2020. There was a decrease in foreign currency credit and profitability levels between 2018 and 2020, in line with the reduction in net interest income and increased rigidities in operating costs. While non-performing loans remained stable in 2020, the extension of the pandemic's effects, together with the expiry of central bank measures and tighter monetary conditions, may contribute to deteriorating the portfolio credit quality.

Chart II.4.1 • Real GDP | Annual % change



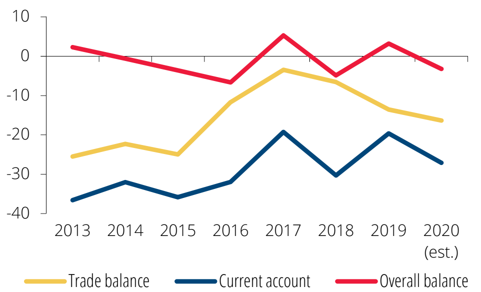
In the year of the outbreak of the COVID-19 pandemic, Mozambique recorded a contraction in economic activity for the first time in the last 30 years. Recovery is expected to continue at a moderate pace, taking into account the identified macroeconomic risks.

Chart II.4.2 • Inflation | Annual % change in the CPI



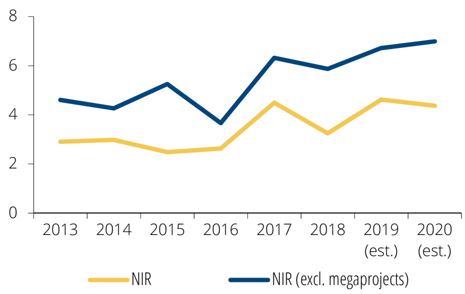
Inflation remained stable between January 2018 and December 2020, rising in the first half of 2021, with the year-on-year rate of change reaching 5.5% in June 2021.

Chart II.4.3 • Balance of payments | % of GDP



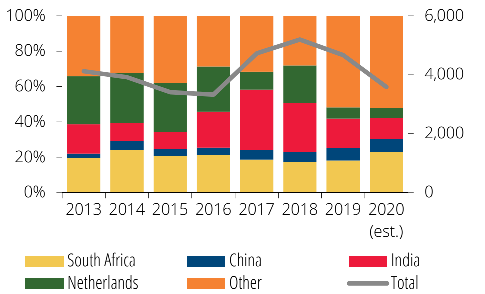
In 2020, the current account was severely affected by the deterioration in the trade balance and increased external debt burden. The overall balance was insufficient to meet the current account deficit.

Chart II.4.4 • Foreign exchange reserves | Months of goods and services imports



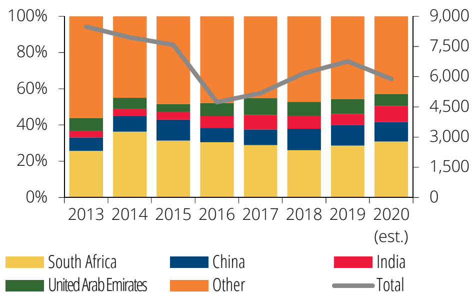
Gross international reserves remained at comfortable levels at the end of 2020, amounting to around 7 months of imports, excluding megaprojects.

Chart II.4.5 • Goods exports | Destinations as a %, total in USD millions



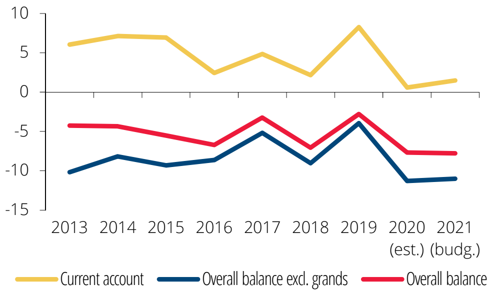
Exports of goods decreased by 23.1% in 2020 due to a fall in trading volumes and prices particularly, mining and quarrying and manufacturing goods). South Africa and India continued to be the main destinations.

Chart II.4.6 • Goods exports | Origins as a %, total in USD millions



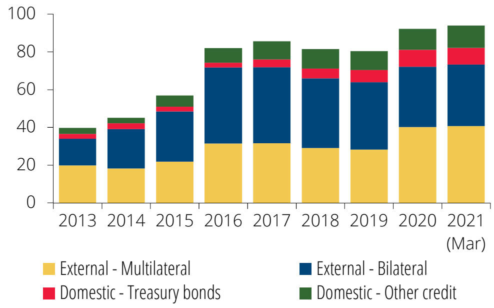
Imports of goods decreased by 12.9% in 2020, especially for intermediate and capital goods, owing to the contraction in economic activity. Around 40% of imports were from South Africa and China.

Chart II.4.7 • Fiscal balances | % of GDP



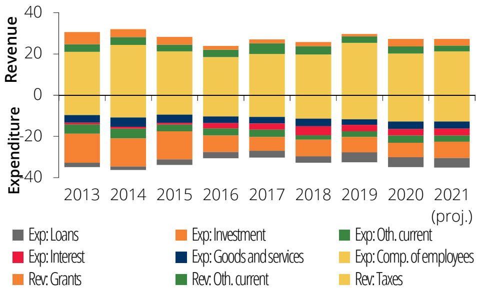
The pandemic imposed a sharp drop in revenue and a slight increase in expenditure, which explains the deteriorating current budget balance in 2020. External grants are expected to stabilise the overall balance in 2021 (3.2% of GDP).

Chart II.4.8 • Public debt | % of GDP



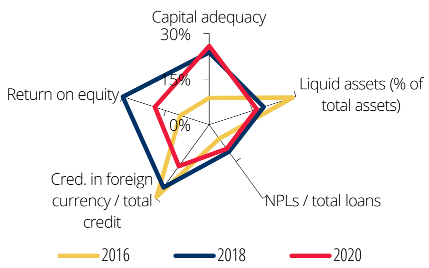
The increase in financing needs and the fall in GDP contributed to the rise in the public debt ratio in 2020. Most notable is the expansion of multilateral external debt and financing using Treasury bonds.

Chart II.4.9 • Public revenue and expenditure | % of GDP



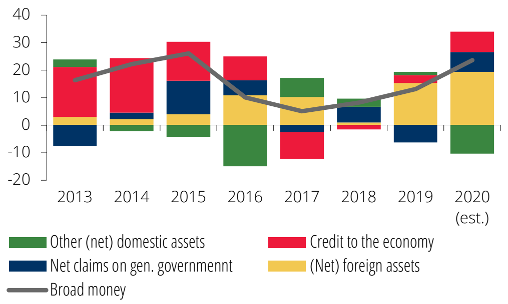
As in 2020, public accounts will continue to be affected by the impact of the pandemic on public revenue and expenditure in 2021, as well as by defence and security expenditure.

Chart II.4.10 • Financial stability indicators



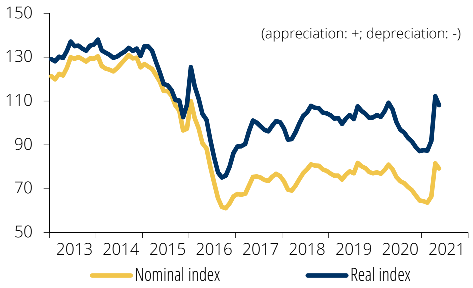
The banking sector maintained appropriate capital, liquidity and profitability levels in 2020, notably the downward trend in the sector's profitability between 2018 and 2020.

Chart II.4.11 • Liquidity expansion/contraction factors | Changes in % of initial stock of broad money



Monetary expansion in 2020 was due to the increase in credit to the economy and claims on general government in the context of a pandemic, with net foreign assets increasing slightly compared with 2020.

Chart II.4.12 • Effective exchange rates | Index 100 = 2010, monthly averages



The average effective exchange rate of the metical posted a depreciation in 2020 (by 16 p.p., in real terms). In May 2021, amid volatility in the foreign exchange market, the metical showed a slight appreciation against pre pandemic levels.

Table II.4.1 • Main economic indicators

		2018	2019	2020		2021	
			Est.	Prog.	Est.	Prog.	Est.
Output and prices							
Nominal GDP	in million EUR	12,972	13,700	11,863	11,459	11,594	–
Real GDP	annual % change	3.4	2.3	-0.5	-1.2	1.6	–
GDP per capita	USD, in PPP(a)	1,321	1,336	–	1,297	–	–
Inflation (CPI)	year-on-year % change	3.5	3.5	4.4	3.5	5.5	5.5 Jun.
Inflation (CPI)	average % change	3.9	2.8	3.6	3.1	5.3	4.2 Jun.
Public finances							
Total revenue	% of GDP	25.8	29.7	25.0	27.2	27.3	–
Total expenditure	% of GDP	32.8	32.5	28.4	34.9	35.0	–
Overall balance	% of GDP	-7.0	-2.8	-13.4	-7.7	-7.8	–
Overall balance excluding grants	% of GDP	-9.0	-4.2	-17.4	-11.3	-11.0	–
Public debt	% of GDP	81.4	80.3	–	92.2	–	94.3 Mar.
Domestic	% of GDP	15.4	16..3	–	20.1	–	20.7 Mar.
External	% of GDP	66.0	64.0	–	72.2	–	73.6 Mar.
External	% of exports(b)	164	176	–	233	–	–
Money and credit							
Net claims on general government	annual % change	64.1	-44.6	198.1	112.0	–	21.2 Jun.
Credit to the economy	annual % change	-2.5	-5.0	1.7	15.0	8.4	2.4 Jun.
Broad money (M3)	annual % change	8.2	12.1	8.2	23.6	12.1	-0.3 Jun.
Interest rates(b)							
Deposit (1-year)	annual rate	11.2	8.7	–	6.6	–	7.1 Jun.
Lending (1-year)	annual rate	20.7	21.0	–	18.8	–	20.4 Jun.
MIMO rate	annual rate	14.6	12.8	–	10.3	–	13.3 Jun.
Financial stability							
Capital adequacy(c)	%	23.8	28.8	–	25.9	–	26.2 Mar.
NPL/total loans	%	11.1	10.2	–	9.8	–	9.8 Mar.
Return on equity (ROE)	%	29.8	24.9	–	18.7	–	24.3 Mar.
Balance of payments							
Current account	% of GDP	-30.3	-19.8	-66.5	-27.1	-68.8	–
Current account excl. official transfers	% of GDP	-31.0	-25.8	–	-28.7	–	–
Official reserves (net)	months of imports(d)	3.2	4.6	–	5.6	4.4	4.6 Mar.
Exchange rates							
EUR/MZN	average rate	71.2	70.0	–	79.3	–	75.4 Jun.
USD/MZN	average rate	60.3	62.6	–	69.3	–	62.5 Jun.
Nominal EERI(e)	annual % change	2.2	-1.0	–	-12.5	–	14.7 May(f)
Real EERI(e)	annual % change	4.0	-1.8	–	-15.5	–	21.0 May(f)

Sources: Banco de Moçambique, International Monetary Fund and Banco de Portugal calculations. | Notes: (a) Purchasing power parity; (b) Exports of goods and services; (c) Regulatory capital/risk-weighted assets; (d) Imports of goods and services for the year (or the previous year for intra-annual figures); (e) Effective exchange rate index, based on the exchange rates of the main trading partners with variable international trade weights, including exports and imports of goods (appreciation: +; depreciation: -); (f) Change in the end-of-period monthly average against the end of December of the previous year.

5 São Tomé and Príncipe

Area 997 km²
Capital city São Tomé
Population 223,345 (2021; source: United Nations)
Currency Dobra (STN)

The economy of São Tomé and Príncipe has shown strong resilience to the effects of the COVID-19 pandemic, with a real growth rate of 3.0% in 2020. Based on these developments, and contrary to initial expectations, São Tomé and Príncipe was one of the few economies in Sub-Saharan Africa to grow last year.

Benefiting from the financial resources provided by international institutions, public expenditure went up with the introduction of measures such as the increase in the number of employees in the health and education sectors, cash and in-kind transfers to the most vulnerable households and to firms, the acceleration of public investment projects, among others. These measures helped offset the sharp fall in the tourism sector.

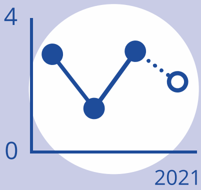
In 2021, the planned introduction of VAT, an updated tax structure and more efficient collection will make it possible to boost revenue.

Inflation worsened in 2020 but slowed down in early 2021, yet there are still risks of steeper international prices for oil and food in general.

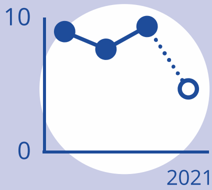
The banking system continues to show weaknesses, but the closure of three institutions in the last few years has led to an improvement in the overall level of profitability, despite the high stock of non performing loans. The central bank has actively undertaken to contain excess liquidity. The country's external accounts show structural vulnerabilities, but financing flows from international institutions have mitigated short-term difficulties.

The third review of the three-year arrangement with the IMF, signed in 2019 under the Extended Credit Facility (ECF), was successfully completed in August 2021. The targets of the main public finance indicators exceeded the figures agreed.

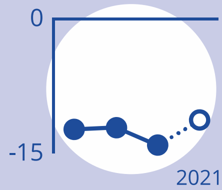
ECONOMIC GROWTH
%



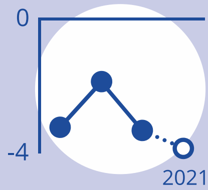
INFLATION
year-on-year change, %



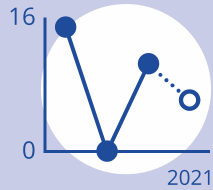
CURRENT ACCOUNT
% of GDP



FISCAL BALANCE
% of GDP



BROAD MONEY
% change



The economy of São Tomé and Príncipe performed better than expected in 2020. In contrast to forecasts made throughout the year, São Tomé was able to mitigate the adverse consequences of the pandemic and of the containment measures in place (such as travel bans and market closures) with a growth rate of 3.0%, the highest in the last three years.

This is particularly relevant as the tourism sector, one of the mainstays of the Santomean economy since 2014, was seriously hit as of March 2020 by the suspension of air links, which were subsequently reopened with great limitations. Other African small island economies that are also tourism-dependent have experienced high output decreases. Tourism's failure to recover should lower the growth rate of the economy in 2021, although it is still expected to remain positive.

The resilience of the Santomean economy was largely thanks to the authorities' ability to implement measures to mitigate the effects of the crisis: hiring more staff for health and education (to decrease the number of students per class and reduce the risk of contagion). Granting cash and in kind transfers to the most vulnerable families, supporting the labour costs of firms that kept their employees, moratoria for taxes and other commitments, extending the public investment programme, building schools and improving the road network, were also implemented among others.

These measures benefited from sizeable financial resources from international institutions (the IMF, the World Bank, the African Development Bank and the European Union) and benefited from initiatives such as the Debt Service Suspension Initiative (DSSI). Given the country's small geographical area and population, these funds made it possible to achieve objectives that would have been difficult to achieve in larger countries. Having fewer treasury constraints, the Government was able to settle a significant volume of internal payments in arrears, which provided liquidity to the corporate sector.

2020 saw an upsurge in inflation, which came close to two digits due to pandemic-related constraints on the production and distribution of goods crucial to the consumption basket of Santomean households, such as fish and vegetables. Inflation started to reverse in the last quarter of 2020, but the future of this trend will depend on the behaviour of international oil and food prices, which are crucial in a country that imports a particularly high share of consumer goods.

Another risk factor is how unsustainable it is to keep public spending at present levels: while many of the measures implemented in 2020 may be reversed, others, such as the increase in the overall public expenditure with salaries, will tend to continue indefinitely. Revenue may not match expenditure, even though the former performed favourably in 2020. Contrary to expectations, there have been significant increases in the collection of taxes (particularly indirect taxes), as a result of reforms carried out at the end of 2019 (higher rates on certain products) and more efficient collection. The prospect of implementing VAT by the end of 2021 and the administrative modernisation of tax collection will benefit from the measures in place to reduce the informal economy, a key process for the logistics of granting benefits to households and firms to mitigate the effects of the pandemic.

The domestic primary fiscal deficit widened from 1.8% to 3.2%, well below the revised projections in the arrangement with the IMF under the ECF programme, which pointed to a deficit above 6% of GDP. This was possible due to the positive performance of revenue and to strong restrictions on the authorisation of new expenditure that did not clearly tackle the pandemic.

Despite the loans received in 2020, the ratio of external public debt to GDP did not worsen, due to nominal output growth, with debt servicing easing because of the DSSI initiative, which includes some main bilateral creditors, such as Portugal.

The country's external vulnerability became more pronounced due to the collapse of tourism revenue, leading to a deficit in the services balance, which had not been observed since 2014. As a result, the current account deficit increased to around 14% of GDP. However, the inflow of funds from international institutions made it possible to avoid the balance of payments reaching a critical situation that might jeopardise maintaining the exchange rate peg to the euro, in force since 2010.

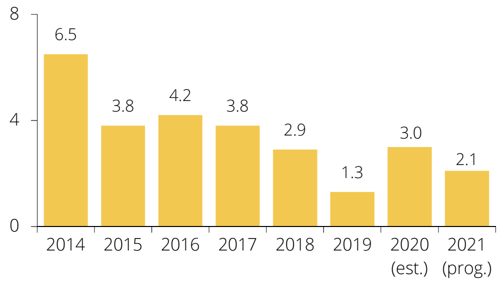
In 2020, trade flows (goods) were stable at levels similar to those of the previous year, in terms of exports and imports. This is despite a substantial shift in the composition of imports: the cost of fuel imports fell significantly (as a result of the fall in oil prices from the 1st quarter of 2020 onwards), while imports of consumer goods and investment rose.

The Netherlands takes up around 50% of Santomean exports. In addition to traditional cocoa exports, it is also the destination for the new palm oil production. In terms of imports, Portugal strengthened its role as main supplier (around 53%), while Angola's market share was halved (from 22% to 11%) as a result of the fall in international oil prices and trade-related difficulties.

The banking sector continued to face the structural problems stemming from the small size of the market, the oversized sector (despite the closure of three out of eight institutions in recent years), the scarcity of opportunities for granting credit with a reasonable level of risk, considerable operating costs and a high level of non-performing loans (around 30%). Despite these factors and the fact that in 2020 the banking authorities imposed caps on bank fees (to increase the use of banking transactions during the pandemic), the sector's profitability improved. This positive development is probably linked to the closure of three institutions and the fact that the bulk of non-performing loans is now adequately provisioned.

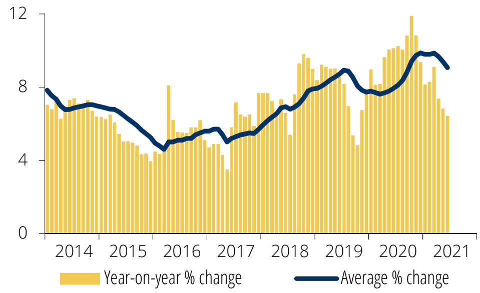
Credit stagnation has contributed to a situation of excess liquidity in the banking system. The central bank has sought to manage this through measures such as changes in the legal reserve rate and new rules for issuing Treasury bills (notably seeking to ensure that the respective interest rate being set in tender reflects market conditions). More recently, the creation of certificates of deposits, issued by the central bank, has increased the availability and flexibility of liquidity management tools.

Chart II.5.1 • Real GDP | Annual % change



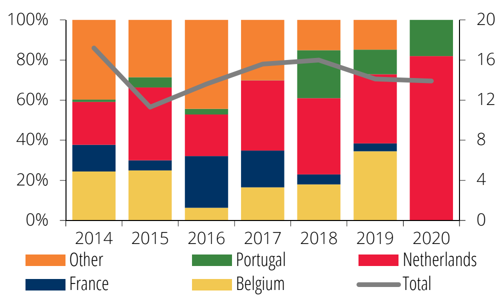
GDP grew by 3% in 2020, benefiting from a high fiscal stimulus that enabled São Tomé and Príncipe to tackle the effects of the pandemic.

Chart II.5.2 • Inflation | Annual % change in the CPI



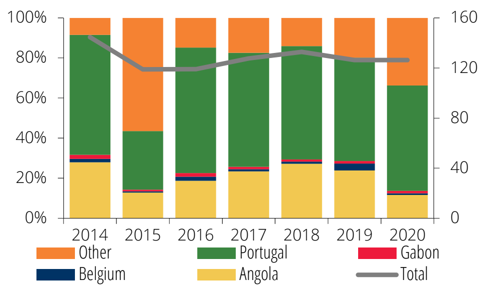
Inflation steepened during 2020 particularly due to the constraints associated with the fight against the pandemic, but has slowed down in recent months.

Chart II.5.3 • Goods exports | Destinations as a %, total in USD millions



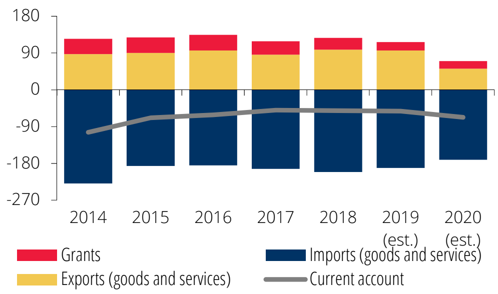
Santomean exports in 2020 maintained the level of the previous year; the Netherlands increased their prevalence as the main buyer of cocoa and palm oil.

Chart II.5.4 • Goods exports | Origins as a %, total in USD millions



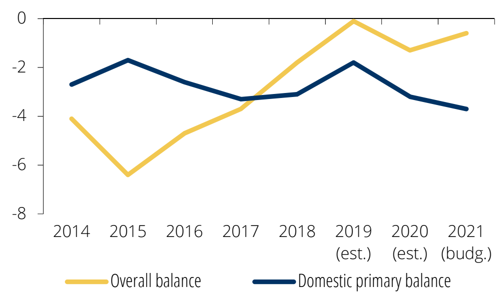
The overall level of imports in 2020 was similar to that of the previous year, despite the fall in the cost of fuel, which penalised purchases from Angola.

Chart II.5.5 • Balance of payments | In USD millions



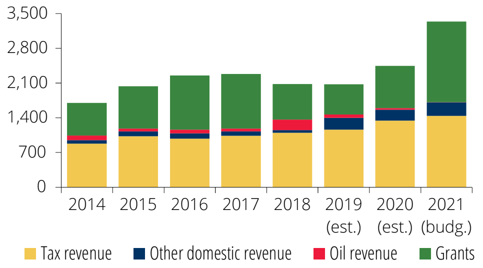
The significant drop in tourism revenue contributed to the deterioration in the current account, despite the reduction in services imports.

Chart II.5.6 • Fiscal balances | % of GDP



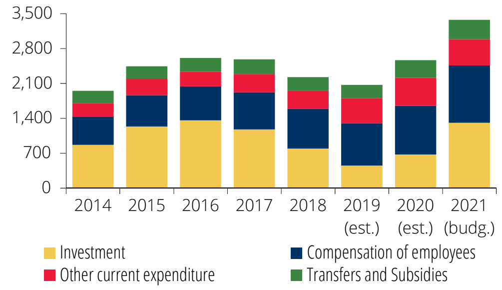
Fiscal balances deteriorated less strongly than expected because of measures to fight the effects of the pandemic.

Chart II.5.7 • Public revenue | STN millions



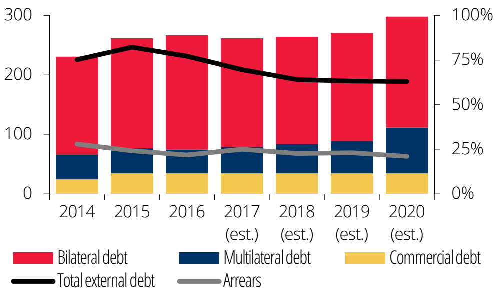
Tax revenue benefited from the changes introduced at the end of 2019 and from increased efficiency in tax collection. Grants increased significantly compared to the previous year.

Chart II.5.8 • Public expenditure | STN millions



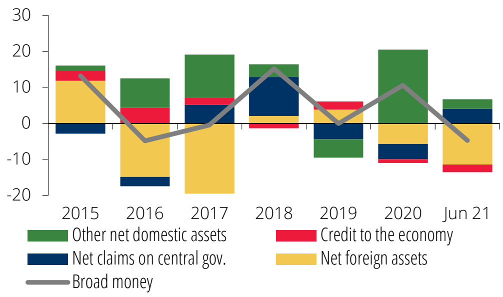
All expenditure components, including public investment, increased compared with 2019 as a result of measures taken to counter the economic and social effects of the pandemic crisis.

Chart II.5.9 • External public debt | USD millions, total and in arrears as a % of GDP



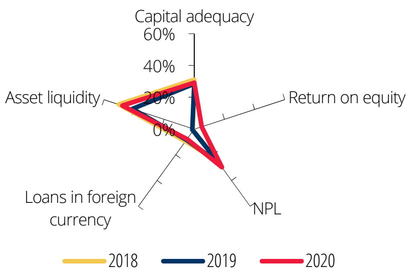
While rising in absolute terms, external public debt relative to GDP remained stable. The policy of settling arrears continued despite difficult circumstances.

Chart II.5.10 • Liquidity expansion / contraction factors | Changes in % of initial stock of broad money



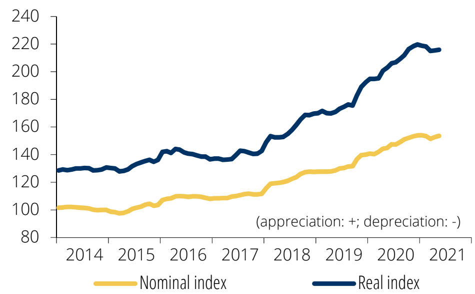
Broad money increased significantly, leading to a situation of excess liquidity, managed by the central bank through the use of different instruments.

Chart II.5.11 • Financial stability indicators



The banking system is still frail, with a very high level of NPLs. However, there has been some gain in profitability following the closure of three institutions in recent years.

Chart II.5.12 • Effective exchange rates | Indices 100 = 2010, monthly averages



The devaluation of the Angolan currency is the main factor of the effective exchange rate index appreciation in nominal terms. Santomean inflation highlights this effect in real terms, impairing external competitiveness.

Table II.5.1 • Main economic indicators

		2018	2019	2020		2021	
			Est.	Prog.	Est.	Prog.[a]	Est.
Output and prices							
Nominal GDP	in million EUR	352	385	366	418	439	–
Real GDP	annual % change	2.9	1.3	-6.5	3.0	2.1	–
GDP per capita	USD, in PPP[b]	4,089	4,175	–	4,274	–	–
Inflation (CPI)	year-on-year % change	9.0	7.7	9.3	9.4	4.7	6,4 Jun.
Inflation (CPI)	average % change	7.9	7.7	9.9	9.9	5.4	9,1 Jun.
Public finances							
Total revenue	% of GDP	24.1	22.0	28.2	23.8	34.7	–
Current revenue	% of GDP	13.4	14.8	14.5	15.3	17.8	–
Grants	% of GDP	8.3	6.4	11.2	8.3	16.9	–
Total expenditure	% of GDP	26.0	22.1	25.0	25.2	35.4	–
Current expenditure	% of GDP	16.6	17.1	20.8	18.5	21.5	–
Investment	% of GDP	9.2	4.8	4.8	6.6	13.6	–
Domestic primary balance[c]	% of GDP	-3.1	-1.8	-5.3	-3.2	-3.7	–
Overall balance	% of GDP	-1.8	-0.1	-1.7	-1.3	-0.6	–
Public debt (includes guaranteed debt)	% of GDP	71.8	90.8	103.0	85.2	87.9	–
External public debt	% of GDP	66.8	63.2	68.2	63.0	63.3	–
Money and credit							
Net claims on central government	annual % change	148.0	-145.7	267.4	216.9	-144.5	-153,8 Jun.[f]
Credit to the economy	annual % change	-1.6	0.03	1.9	-1.6	0.0	-3,3 Jun.[f]
Broad money (M3)	annual % change	15.2	-0.02	1.2	10.6	6.1	-4,7 Jun.[f]
BCSTP reference interest rate	annual rate	9.0	9.0	–	9.0	–	9,0 Jul.
Financial stability							
Capital adequacy[d]	%	31.1	28.5	–	29.2	–	29,6 Mar.
NPL/total loans	%	24.6	26.7	–	29.6	–	29,9 Mar.
Return on equity (ROE)	%	-1.1	-1.4	–	4.8	–	3,6 Mar.
Balance of payments							
Trade balance (goods)	% of GDP	-28.1	-26.1	-19.8	-23.5	-23.1	–
Services balance	% of GDP	3.4	17.6	-28.6	-7.0	-2.7	–
Current account	% of GDP	-12.3	-12.1	-17.4	-14.1	-11.3	–
Official reserves	months of imports[e]	2.2	2.8	3.5	4.3	4.0	2,9 Jun.
Exchange rates							
EUR/STN	average rate	24.5	24.5	24.5	24.5	24.5	24,5 Jun.
USD/STN	average rate	20.9	22.1	22.0	21.7	20.1	21,9 Jun.
Nominal EERI[f]	annual % change	11.2	7.4	–	11.9	–	-0,3 May[g]
Real EERI[f]	annual % change	14.0	10.9	–	17.1	–	-1,7 May[g]

Sources: Banco Central de São Tomé e Príncipe, Ministry of Planning, Finance, and the Blue Economy of São Tomé and Príncipe, International Monetary Fund and Banco de Portugal calculations. | Notes: (a) Figures for 2021 correspond to the forecasts agreed between the Santomean authorities and the IMF (July 2021 ECF report); figures for public finances are those in the 2021 Budget; (b) Purchasing power parity; (c) The domestic primary balance corresponds to the overall balance (commitment basis) excluding grants, oil revenue, debt interest and investment financed using external sources; (d) Regulatory capital/risk-weighted assets; (e) Imports of goods and services, programmed in n-1 for year n; (f) Effective exchange rate index, based on the exchange rates of the main trading partners with variable international trade weights, including exports and imports of goods (appreciation: +; depreciation: -); (g) Change from December 2020.

6 Timor-Leste

Area 14,954 Km^2

Capital city Dili

Population 1,344 million (2021; source: United Nations)

Currency US dollar (USD)

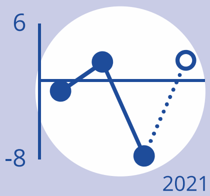
In 2020 the economy of Timor-Leste was greatly affected by the COVID-19 pandemic. The authorities took measures to limit mobility and impose a lockdown. The structural characteristics of the Timorese economy and society, which considerably limit remote working, led to a contraction in economic activity that resulted in a 7.6% drop in GDP in 2020. The recovery estimated for 2021 is not expected to exceed 2.0%, as the April floods, which destroyed infrastructures and homes, namely in the country's capital, added to the effects of the pandemic.

The late approval of the 2020 budget (at the start of the fourth quarter) also affected the dynamics of the economy, which is highly dependent on public expenditure outturn. This was in spite of the steps taken from March onward to mitigate the effects of the pandemic (transfers of cash and basic needs to households, support to firms to preserve jobs, credit moratoria, etc.). However, in 2020 government expenditure was lower than in the previous year, due to a fall in public investment.

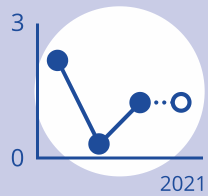
Inflation, which remained low in 2020, picked up in 2021, mostly owing to increases in transport costs (an effect of the rise in fuel prices), as well as new mobility restrictions and higher imported food prices.

The banking system continues to have a very reduced presence, namely in terms of credit. The Petroleum Fund, managed by the central bank, saw an appreciation of its assets in 2020 and in the first half of 2021, despite an increase in transfers to the Treasury.

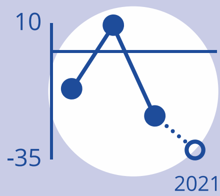
ECONOMIC GROWTH
%



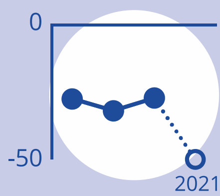
INFLATION
year-on-year change, %



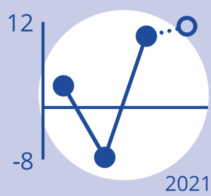
CURRENT ACCOUNT
% of GDP



FISCAL BALANCE
% of GDP



BROAD MONEY
% change



The economy of Timor-Leste posted an estimated negative growth of 7.6% in 2020. The contraction observed was mainly the result of the restrictive measures taken at the end of the first quarter to contain the spread of the COVID-19 pandemic, given that the health system was not prepared to deal with a health crisis similar to that of other countries in the continent at the time.

Severe limitations to mobility (closure of borders, serious restrictions on internal movement, strict lockdown rules, etc.) had a strong impact on economic activity, which dropped to a minimum from April, as important sectors (trade, restaurants, transport and even most of the general government) were not prepared for remote working.

In addition, the traditional economic stimulus from public expenditure was also compromised by the fact that the budget for 2020 was only approved at the start of October 2020, with public finances having been managed under a provisional twelfths system until then.

This did not affect the implementation of measures to mitigate the social and economic effects of the pandemic, as a fund was created in the meantime – ratified by Parliament and financed by transfers from the Petroleum Fund – to, inter alia, in the absence of an approved budget, provide cover (and transparency) to measures aimed at strengthening the healthcare system, provide monetary subsidies to lower-income households (the large majority of the population), distribute basic food and personal care baskets, build rice stocks (Timor-Leste's basic food staple), and support firms to preserve jobs.

In addition to the 2021 budget, a short to medium-term Economic Recovery Plan was approved at the end of 2020, the implementation of which has been hampered by increasing restrictions as a result of the second wave of the pandemic in 2021 and the damage caused by the floods at the beginning of April, which destroyed homes and infrastructures, such as roads, bridges and telecommunication towers.

Despite the increase in a number of public expenditure items, namely transfers, linked to the aforementioned measures, overall this aggregate did not increase from 2019, because of a substantial decline in investment expenditure. In 2021 a timely budget approval and a higher expenditure outturn should lead to a modest economic recovery, with growth estimated at 2.0%.

The basic food basket and the sale of rice at controlled prices allowed inflation to remain below 1% for almost all of 2020. In 2021 the hike in fuel and food prices led to a price increase in the first half of the year that is uncommon in Timor-Leste, with the year-on-year inflation rate reaching 3.6% in June.

The production and sale of coffee, the country's main export commodity, was also affected by pandemic related restrictions: sales abroad dropped by around a third, in the absence of a number of traditional buyers, especially of the more sought-after varieties. Oil and gas exploration in the Timor Sea is still not taken into account in the calculation of the country's output and exports. This might change soon when the maritime border with Australia is established. This offshore activity is reflected in foreign income (payment of taxes and royalties by external companies operating such explorations) and consequently in Timor-Leste's national income. In 2020 this contribution was smaller, reflecting the joint effect of lower production (the current oil field is almost depleted) and a fall in oil prices.

Due to the drop in exports and foreign income, the current account again posted a negative balance in 2020, despite the decline in imports observed in capital goods and fuel (the latter owing to a price effect).

Public finance management was affected by the provisional twelfths system and extraordinary pandemic-related expenses. Similarly to previous years, the outturn rate was low (approximately 76%) and the deficit was lower than in previous years (in absolute terms). The increase in current expenditure was more than offset by the 50% decrease in investment expenditure, as a result of the constraints related to the lack of a budget and the disruption to the government's regular activity.

In 2020 public revenue remained at 2019 levels. The decline in domestic (tax) revenue was offset by higher scheduled transfers from the Petroleum Fund, which are automatically calculated according to this Fund's 'estimated sustainable income' methodology.

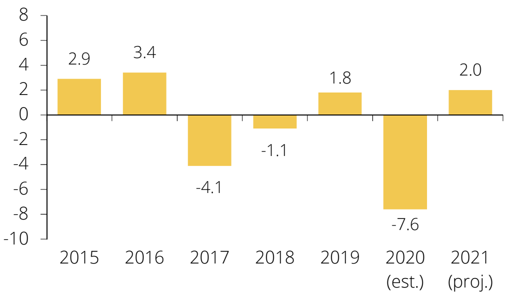
As in previous years, in 2020 fiscal deficit financing was mostly ensured by extraordinary transfers from the Petroleum Fund that require explicit approval by Parliament because they exceeded the estimated sustainable income of oil wealth. However, in 2020 this additional funding was lower than in previous years (USD 342 million in 2020 compared with USD 440 million in 2019).

In 2020 the value of the **Petroleum Fund** increased from USD 17.7 billion to USD 19.0 billion (11 times the country's GDP), benefiting from an appreciation of its financial assets and lower total transfers to the Treasury. This behaviour continued over the course of the first half of 2021, with the Fund's value reaching USD 19.5 billion at the end of June. However, this Fund's medium-term outlook should be taken into account against developments in the Bayu Undan oil field (the only oil field currently under exploration) and revenue and expenditure dynamics.

Bank lending grew by around 10% in 2020, but the **banking system** continues to have a reduced presence in economic terms. Funds raised (deposits) account for approximately three times the volume of credit granted; consequently, the largest asset component in banks' balance sheets are investments abroad. Legal, institutional and economic limitations to the expansion of credit are very significant and, although non-performing loans are residual (below 4%), banking institutions have adopted a conservative approach. Since mid-2020, a credit moratorium scheme has been in place and authorities have implemented a credit guarantee scheme to facilitate access by firms to bank credit.

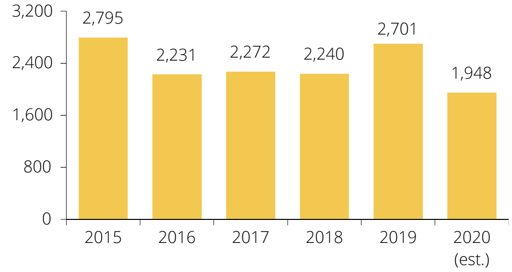
The US dollar has been the official currency of Timor-Leste since 2001 and, since 2003, banknote circulation has been complemented by national coins issued by the central bank with a fixed value against the US currency. The appreciation observed in the US dollar in the second quarter of 2020 temporarily affected the currency's stability against the currencies of Timor-Leste's main trading partners (Indonesia, Australia, China, Singapore), which it has since recovered from the second half of the year onwards. The rise in inflation in Timor-Leste throughout 2021 has led to a loss in the country's external competitiveness, as assessed by the real effective exchange rate index.

Chart II.6.1 • Real GDP | Annual % change



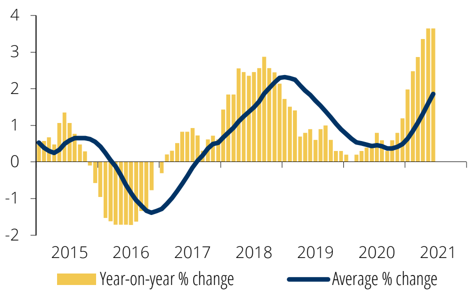
The behaviour of the economy in 2020 was strongly hampered by the restrictive measures taken to contain the pandemic. These affected economic activity as a whole, which is highly dependent on the free movement of persons.

Chart II.6.2 • National Income | USD millions



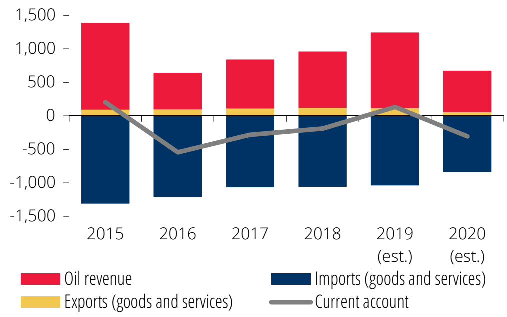
In addition to the fall in domestic economic activity, a decline in oil revenue reduced national income, which dropped to the lowest level in recent years.

Chart II.6.3 • Inflation | Annual % change in the CPI



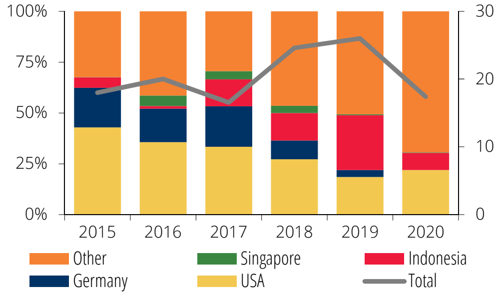
The rise in fuel and food prices led to an increase in inflation throughout the first half of 2021, in contrast to the moderation observed in 2020.

Chart II.6.4 • Current account | USD millions



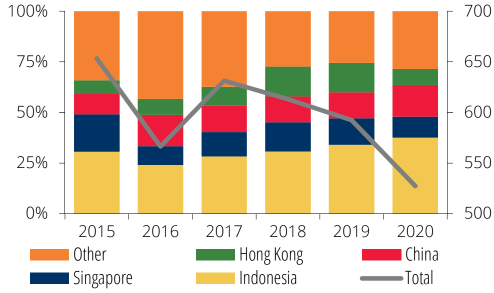
The current account again recorded a deficit in 2020, with oil revenue (taxes and income from the Petroleum Fund) falling more than imports.

Chart II.6.5 • Goods exports | Destinations as a %, total in USD millions



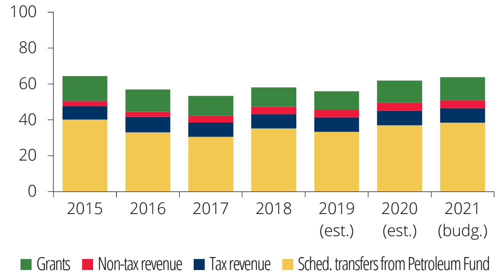
Restrictions on mobility led to a decline in coffee exports, which is virtually the only export commodity of Timor-Leste. The presence in the economy of some of the country's traditional customers (Germany, Singapore) was non-existent in 2020.

Chart II.6.6 • Goods imports | Origins as a %, total in USD millions



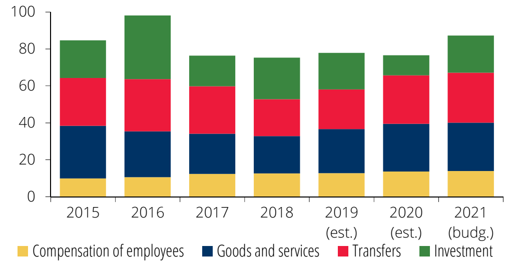
The falls recorded in investment (an important factor behind the purchase of building materials and equipment abroad) and fuel prices accelerated the drop in imports, which reached their lowest level in eight years.

Chart II.6.7 • Public revenue | % of GDP



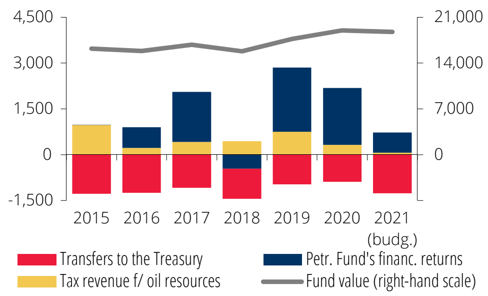
Scheduled transfers from the Petroleum Fund continue to be the largest component of public revenue. Grants increased in 2020.

Chart II.6.8 • Public expenditure | % of GDP



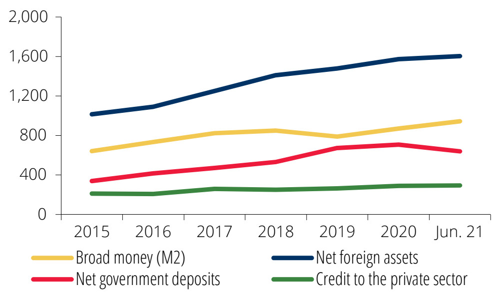
In 2020 public expenditure was affected by the late approval of the budget (namely, the public investment component), despite the increase in social transfers.

Chart II.6.9 • Petroleum Fund | USD millions



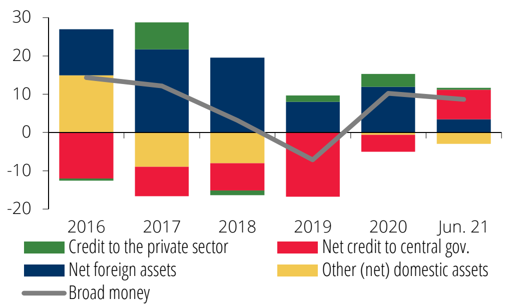
The increase in the value of the Petroleum Fund's financial assets led to an appreciation of the Fund in 2020, in spite of the drop in tax revenue paid by oil companies.

Chart II.6.10 • Monetary aggregates | USD millions



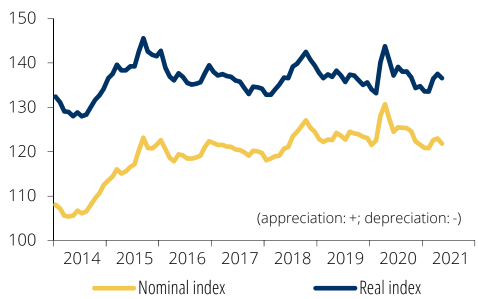
Broad money recovered from the decline observed in 2019, helped by a normalisation of State payments. Bank credit continued to have a reduced presence.

Chart II.6.11 • Liquidity expansion / contraction factors | Changes in % of initial stock of broad money



The increase in net foreign assets was the main factor behind the rise in broad money in 2020, despite a slight recovery in credit.

Chart II.6.12 • Effective exchange rates | Indices 100 = 2010, monthly averages



The appreciation of the US dollar in the first half of 2020 was later adjusted. In turn, the rise in inflation in 2021 led to a loss in the country's external competitiveness.

Table II.6.1 • Main economic indicators

		2018	2019 Est.	2020 Prev.	2020 Est.	2021 Prev.	2021 Est.
Output, income and prices							
Nominal GDP	USD million	1,564	1,591	1,568	1,471	1,500	–
Real GDP	annual % change	-1.1	1.8	-6.0	-7.6	2.0	–
GDP per capita	USD, in PPP[(a)]	3,125	3,073	–	3,356	–	–
National income	USD million	2,240	2,701	2,154	1,948	1,754	–
Inflation (CPI)	year-on-year % change	2.1	0.3	1.0	1.2	1.2	3.6 Jun.
Inflation (CPI)	average % change	2.3	0.9	1.0	0.5	0.5	1.9 Jun.
Public finances							
Total revenue	% of GDP	58.3	55.9	57.4	61.9	63.7	–
Tax revenue	% of GDP	8.0	8.1	7.3	8.1	8.1	–
Non-tax revenue	% of GDP	4.0	4.4	3.7	4.3	4.5	–
Scheduled transfers from the Petroleum Fund	% of GDP	35.2	33.2	34.7	37.0	38.4	–
Project grants	% of GDP	10.9	10.2	11.7	12.5	12.7	–
Total expenditure	% of GDP	86.5	88.3	107.2	89.7	113.7	–
Current expenditure	% of GDP	53.0	58.3	81.3	66.3	80.8	–
Investment	% of GDP	22.5	19.8	14.2	10.9	20.1	–
Overall balance	% of GDP	-28.1	-32.4	-49.8	-27.8	-49.9	–
Oil revenue[(b)]	% of GDP	-0.8	179.6	59.2	148.6	48.6	–
Petroleum Fund	USD billion	15.8	17.7	17.7	19.0	18.8	19.5 Jun.
Petroleum Fund	% of GDP	1,011	1,112	1,126	1,291	1,252	1,299 Jun.
External public debt	% of GDP	9.1	12.1	16.1	14.8	18.5	–
Money and credit							
Net foreign assets[(c)]	annual % change	12.9	4.8	–	6.3	–	1.9 Jun.[(d)]
Credit to the economy	annual % change	-3.8	5.5	–	10.1	–	1.4 Jun.[(d)]
Net central government deposits	annual % change	12.5	26.5	–	5.1	–	-9.5 Jun.[(d)]
Broad money (M2)	annual % change	3.1	-7.1	–	10.2	–	22.4 Jun.[(d)]
Loans/deposits	%	30.1	34.3	–	34.3	–	32.0 Jun.
NPL/total loans	%	15.6	6.2	–	3.4	–	–
Balance of payments							
Current account	% of GDP	-12.2	8.4	–	-20.9	–	–
Current and capital accounts	% of GDP	-8.9	10.0	–	-20.1	–	–
Public foreign assets[(e)]	months of imports[(f)]	177	212	–	281	–	248 Jun.
Exchange rates							
USD/IDR (Indonesia)	average rate	14,232	14,118	–	14,573	–	14,500 Jun.
USD/AUD (Australia)	average rate	1.34	1.44	–	1.45	–	1.31 jun.
Nominal EERI[(g)]	annual % change	4.0	-1.1	–	-1.2	–	0.2 May[(d)]
Real EERI[(g)]	annual % change	3.9	-2.7	–	-0.6	–	1.3 May[(d)]

Sources: Banco Central de Timor-Leste, Ministry of Finance of Timor-Leste, IMF, World Bank, Asian Development Bank and Banco de Portugal calculations. | Notes: (a) Purchasing power parity; (b) Oil revenue corresponds to tax revenue from oil and gas exploitation plus the financial return of the Petroleum Fund; (c) Does not include the assets of the Petroleum Fund, which are managed by the central bank but are not part of its balance sheet; (d) Change from December 2020; (e) Public foreign assets correspond to the sum of the central bank's foreign exchange reserves and the value of Petroleum Fund assets; (f) Goods and services imports; (g) Effective exchange rate index, based on the exchange rates of the main trading partners with variable international trade weights, including exports and imports of goods (appreciation: +; depreciation: -).

Box 3 • Effective exchange rate index – methodology review

Globalisation and the growing involvement of emerging and developing economies in international trade counsel a periodic review of the relative weight of currencies and price developments considered when calculating the effective exchange rate index (EERI), in order to suitably reflect the importance of commercial transactions over time. The EERI is the result of the weighted geometric average of exchange rate of a country's currency in relation to the currencies of selected trading partners, considering the relative importance of each country on bilateral trade.

This concern was underlying the EERI series updates carried out by other institutions over recent years, and is equally the origin of the update of the methodology for calculating the (nominal and real) EERI series released in this report and its statistical annexes.

This review complied with the principles disclosed by the main international institutions such as the ECB, Eurostat/European Commission, BIS and IMF, whilst taking into account data availability and the purpose of the exercise.

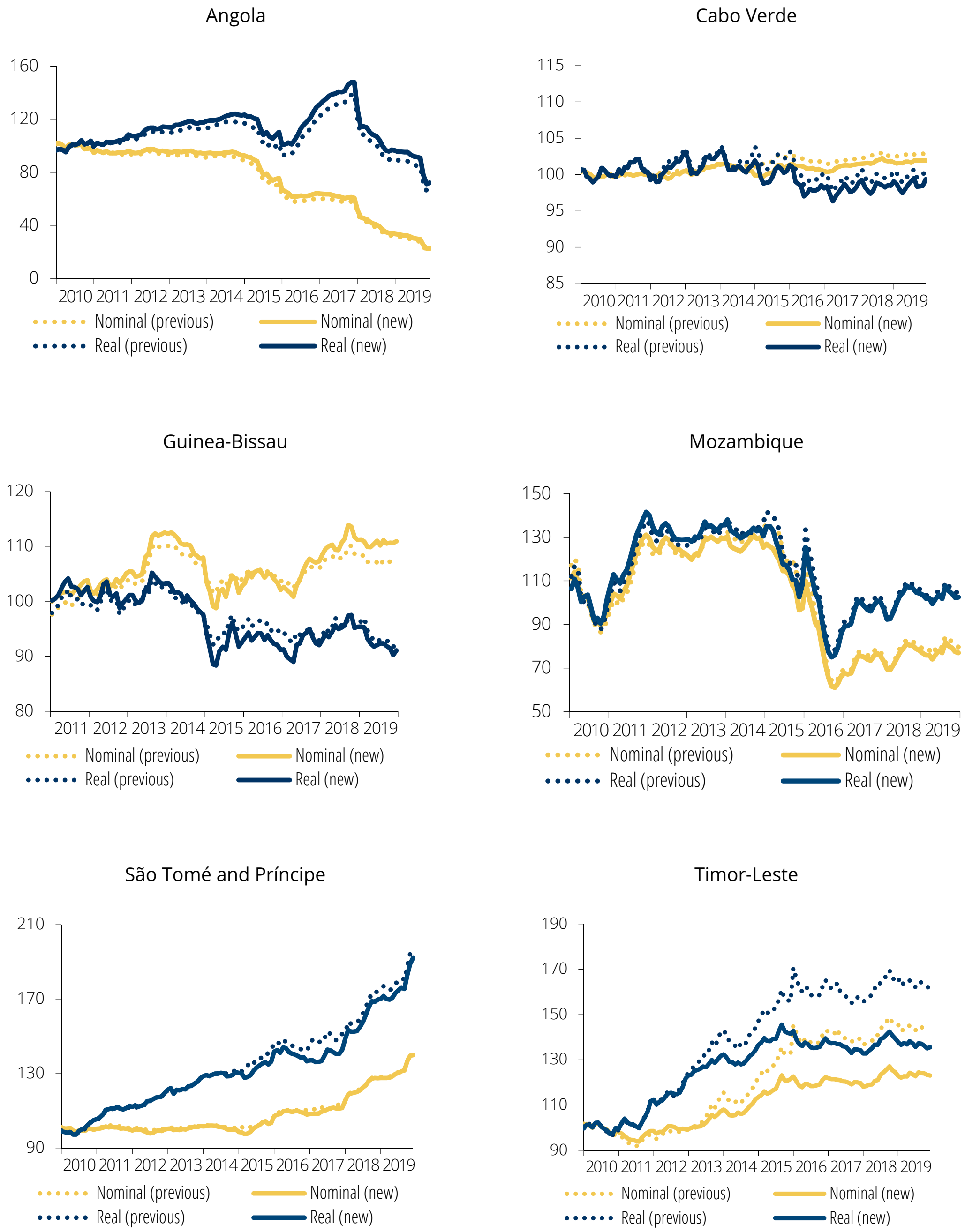
The current update includes:

- reviewing the calculation method of the weights of international merchandise trade , aiming to:
  - Increase total merchandise exports and imports coverage during the period under review (comprising all trading partners with a relative weight of over 2.5% of total merchandise exports and imports of the country/currency under analysis);
  - incorporate the changes of trading partners using weights that vary over time, corresponding to the average value of the trading partner's/currency's relative weight as a proportion of total international trade in successive three-year peri-ods (four reference periods were considered, 2009-11, 2012-14, 2015-17 and 2018-20);
- updating and defining a baseline year for the series, common to all the economies under analysis, with the adoption of 2010 (=100);
- identifying a single source of data, with recourse to information published by the IMF on nominal bilateral exchange rates, consumer price indices and merchandise trade flows (subject to validation or update based on information reported by the different national authorities).

The new EERI series behave in a similar way to those previously released, resulting in changes of similar sign and magnitude, with the differences being explained by the greater coverage of trading partners. However, this methodological review has resulted in a more robust indicator to trace the variations in the currency's value in relation to the currencies of trading partners (nominal EERI) or to assess the developments in the economy's external competitiveness (real EERI). On one hand, because it widens the base of considered trading partners, the weights reflect, on average, 80% of merchandise international trade to the set of six countries under analysis during the period 2009-20. On the other, because this update ensures the flexibility required to automatically adapt the indicator to changes in the structure of each country's international trade at different moments in time, reflecting long and short-term changes more precisely.

Despite the difficulties inherent in data availability and quality, this methodology may, in the future, make it possible to analyse EERI sensitivity to changes in trade flows considered in the calculation of international trade weights, for example, by possibly including international trade in services or by differentiation of commodity trade.

Chart C3.1 • Effective exchange rate index (EERI) | comparison of methodologies



III Economic and financial relations

1 Portugal’s economic and financial relations with Portuguese-speaking African countries and Timor-Leste

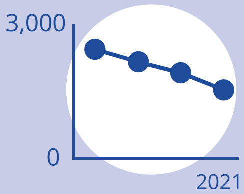
Portuguese trade with Portuguese-speaking African countries and Timor-Leste decreased in 2020, following the downward trend of global trade. Portuguese goods imports from these countries dropped from 2019 by 61% to 2.8% of total imports. Goods exports continued on a downward path, falling by 20% and accounting for 0.6% of Portuguese exports.

Portuguese direct investment in this group of countries recorded a negative net value in 2020. However, investment by Portuguese-speaking African countries in Portugal, directed mainly towards the services sector, reinforced its positive balance.

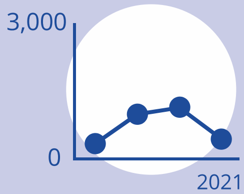
In 2020, the official debt of Portuguese-speaking African countries to Portugal maintained the downward trend of the previous year, driven by debt reductions in Angola and Mozambique. Portugal joined the Debt Service Suspension Initiative and relieved the debt service of some of these countries, namely Cabo Verde, Mozambique and São Tomé and Príncipe.

Despite the particularities of 2020 and as in previous years, Angola remained, of all the countries under consideration, the main destination market for Portuguese exports and market of origin for goods imports. It is also the main foreign direct investor and the country that registered the highest official debt to Portugal.

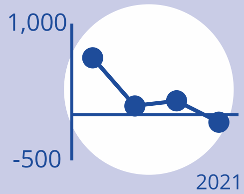
EXPORTS TO PORTUGUESE-SPEAKING AFRICAN COUNTRIES AND TIMOR-LESTE
EUR millions



IMPORTS FROM PORTUGUESE-SPEAKING AFRICAN COUNTRIES AND TIMOR-LESTE
EUR millions



DIRECT INVESTMENT IN PORTUGUESE-SPEAKING AFRICAN COUNTRIES AND TIMOR-LESTE
EUR millions



OFFICIAL DEBT OF PORTUGUESE-SPEAKING AFRICAN COUNTRIES TO PORTUGAL
EUR millions

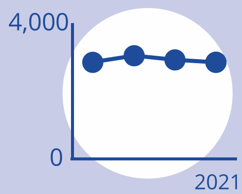
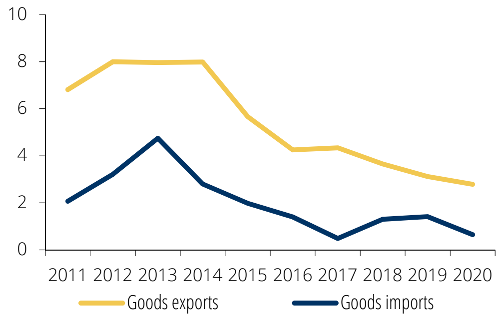
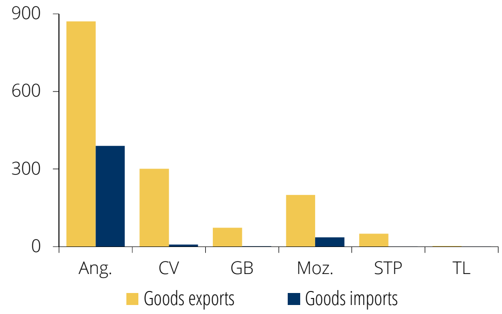


Chart III.1.1 • Portugal's trade relations with Portuguese-speaking African countries and Timor-Leste | % of total



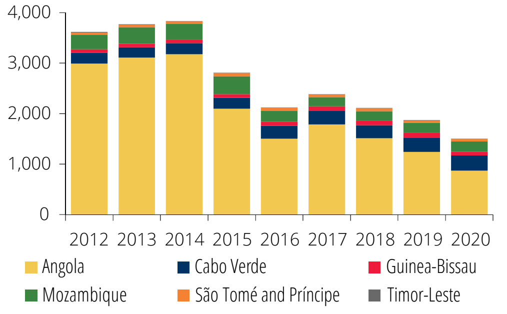
In 2020, the share of exports and imports from Portugal to and from Portuguese-speaking African Countries and Timor-Leste decreased.

Chart III.1.2 • Portugal's trade relations with Portuguese-speaking African countries and Timor-Leste | EUR millions



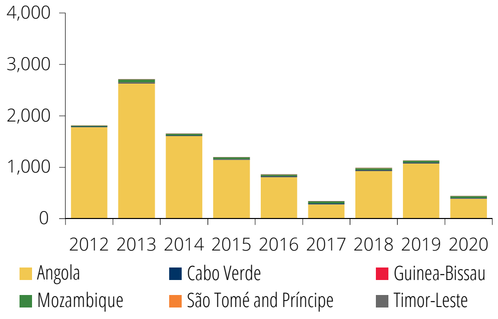
In spite of this reduction, Angola stood out in Portugal's trade with this group of countries in 2020, with 58% of exports and 89% of imports. Angola was followed at some distance by Cabo Verde e Mozambique.

Chart III.1.3 • Portuguese exports of goods to Portuguese-speaking African countries and Timor-Leste, by destination | EUR millions



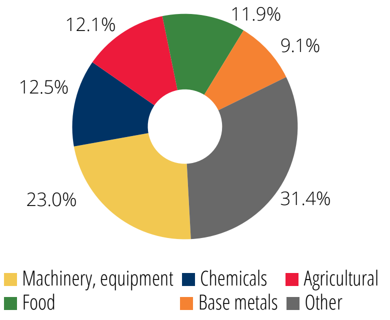
Angola stood out as the main market for Portuguese exports in spite of the downward path recorded since 2018 that has determined the developments in the total aggregate.

Chart III.1.4 • Portuguese imports of goods to Portuguese-speaking African countries and Timor-Leste, by destination | EUR millions



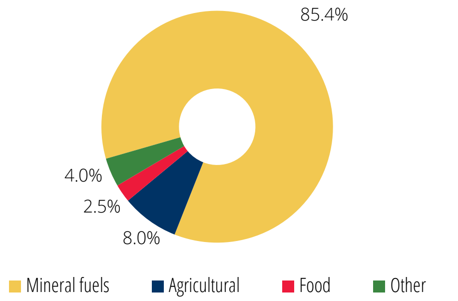
Fuels from Angola constitute the overwhelming majority of goods imports from Portuguese-speaking African countries and Timor-Leste, although decreasing in 2020, thus reverting the upward trend of the two previous years.

Chart III.1.5 • Portuguese exports of goods to Portuguese-speaking African countries and Timor-Leste, 2020 | By group of products



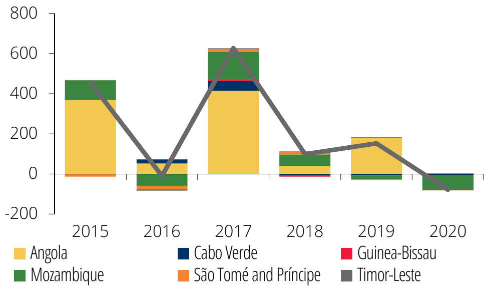
The five major groups of products exported by Portugal to Portuguese-speaking African countries and Timor-Leste accounted for nearly 70% of total exports in 2020, as has been the case for more than a decade.

Chart III.1.6 • Portuguese imports of goods to Portuguese-speaking African countries and Timor-Leste, 2020 | By group of products



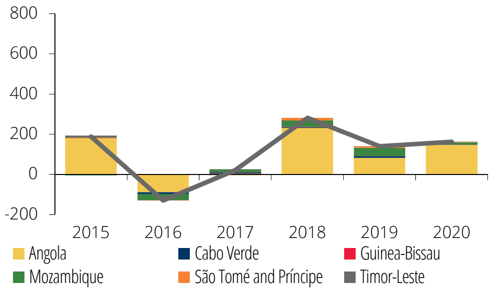
The sectoral structure of Portuguese imports from these countries has remained highly stable, led by Angolan fuels and followed, at a distance, by agricultural goods and food from Mozambique.

Chart III.1.7 • Portuguese direct investment in Portuguese-speaking African countries and Timor-Leste | Total and by country, EUR millions



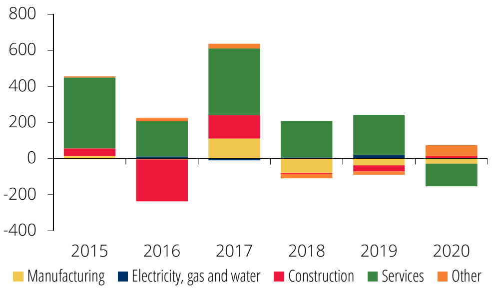
Portugal recorded a net direct disinvestment in Portuguese-speaking African countries and Timor-Leste in 2020, particularly in Mozambique.

Chart III.1.8 • Direct investment by Portuguese-speaking African countries and Timor-Leste in Portugal | Total and by country, EUR millions



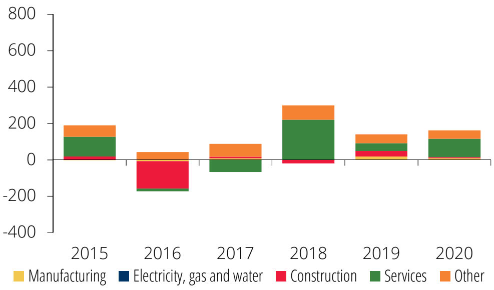
In 2020, direct investment by Portuguese-speaking African countries and Timor-Leste in Portugal remained unchanged, with Angola's figures being the most significant.

Chart III.1.9 • Portuguese direct investment in Portuguese-speaking African countries and Timor-Leste | By sector of activity, EUR millions



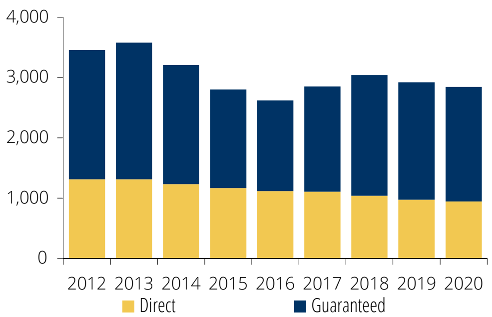
In 2020, Portuguese net direct disinvestment in Portuguese-speaking African countries and Timor-Leste occurred predominantly in the services sector, including financial and insurance activities.

Chart III.1.10 • Direct investment by Portuguese-speaking African countries and Timor-Leste in Portugal | By sector of activity, EUR millions



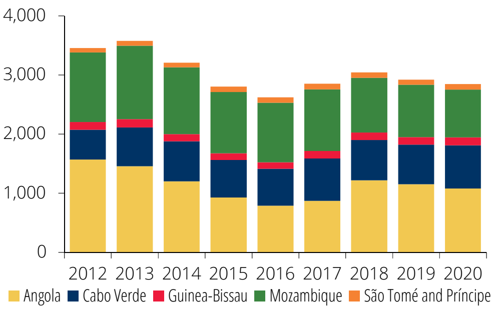
Net direct investment of Portuguese-speaking African countries and Timor-Leste in Portugal in 2020 was concentrated in the sectors of services, manufacturing and construction.

Chart III.1.11 • Official debt of Portuguese-speaking African countries to Portugal | USD millions



In 2020, the official debt of Portuguese-speaking African countries to Portugal maintained the downward trend of the previous year, combining reductions in Portuguese State-guaranteed debt and direct debt.

Chart III.1.12 • Official debt of Portuguese-speaking African countries to Portugal | By country, USD millions



The official debt of Portuguese-speaking African countries to Portugal in 2020 decreased due to the decline in Angola's e Mozambique's amounts. The remaining countries recorded an increase in official debt.

Table III.1.1 • Main indicators (Portugal's perspective) | EUR millions

	2016	2017	2018	2019	2020
Trade with Portuguese-speaking African countries and Timor-Leste					
Goods exports	2,125.6	2,386.8	2,111.9	1,870.7	1,498.7
Angola	1,501.6	1,786.2	1,512.8	1,238.8	871.0
Cabo Verde	258.6	266.8	254.1	284.3	300.9
Guinea-Bissau	78.4	91.2	94.9	91.3	73.4
Mozambique	214.7	180.4	185.8	203.2	199.9
São Tomé and Príncipe	64.1	56.3	59.7	48.8	50.3
Timor-Leste	8.2	5.9	4.6	4.3	3.2
Goods imports	858.4	336.3	985.0	1,130.4	436.7
Angola	809.8	278.9	928.6	1,075.5	389.4
Cabo Verde	11.3	14.9	14.3	12.2	8.2
Guinea-Bissau	0.3	0.3	0.6	0.8	1.9
Mozambique	35.9	41.4	40.2	40.7	35.8
São Tomé and Príncipe	0.3	0.4	0.6	0.3	1.2
Timor-Leste	0.9	0.5	0.7	1.0	0.4
Goods exports (% of Portugal's total exports)	4.2	4.3	3.7	3.1	2.8
Goods imports (% of Portugal's total imports)	1.4	0.5	1.3	1.4	0.6
Bilateral accounts with Portuguese-speaking African countries and Timor-Leste					
Goods	1,329.0	2,060.1	1,201.8	823.5	1,087.0
Current account	3,285.5	4,374.6	3,050.8	2,763.3	2,293.8
Capital account	-27.7	-30.2	-31.0	-35.7	-38.5
Foreign direct investment					
From Portugal in Portuguese-speaking African countries and Timor-Leste	-9.6	627.0	98.9	152.5	-78.9
From Portuguese-speaking African countries and Timor-Leste in Portugal	-129.5	21.2	281.3	140.6	162.2
Official debt of Portuguese-speaking African countries to Portugal					
Total	2,621.8	2,853.2	3,042.8	2,922.6	2,845.9
Angola	786.9	868.8	1,218.0	1,154.8	1,077.7
Cabo Verde	625.0	717.8	683.8	669.5	731.5
Guinea-Bissau	110.4	127.4	123.3	122.5	135.4
Mozambique	1,007.8	1,044.2	926.6	886.7	807.9
São Tomé and Príncipe	91.8	95.0	91.1	89.0	93.5

Sources: Statistics Portugal, Banco de Portugal and Ministry of Finance – GPEARI.